Staples Tax Guide
2012
In 1972 I was drawn into the politics of animal protection when I was invited to join the committee of the SPCA, Auckland. A year later I was elected vice-president of the Royal New Zealand Federation of Societies for the Prevention of Cruelty to Animals (later to be renamed the Royal New Zealand Society for the Prevention of Cruelty to Animals) and in 1975 I was elected President of that Federation. The first seed was probably sown in my early days in the New Zealand Police. In the mid-1960s I was called to a cruelty complaint in South Auckland and ended up keeping the victim – a fantastic German Shepherd I named Karl. He died some 14 years later.

I was naïve enough to think that I could change the law overnight. But I was not a lawyer—then. Thirty-nine years later the work is not done—and probably never will be done as animal protection law will always reflect the moral values of society at the time. As that changes so too will animal welfare law, sometimes tardily—but mostly eventually.

In 1976 I came to the harsh realisation that, while the Department of Agriculture (as it was then known) was appointing inspectors under the Animals Protection Act 1960 on the recommendation of the RFNZSPCA, there was no training. Inspectors were given their warrant and a copy of the Animals Protection Act 1960 and cast into the world. That started a life-long obsession to provide at least some rudimentary training for animal welfare inspectors and that led, in 1977, to my writing a correspondence course for inspectors. It covered the following topics:

• Powers and appointment of Inspectors
• Definitions and exemptions
• Offences and exemptions
• Offences of cruelty and aggravated cruelty
• Parties to offences, attempts and other offences
• Inspectors' practice
• Investigations and prosecutions
• Freezing works
• Euthanasia.

Looking back it was woefully deficient but at the time there was nothing else. Some of my research from those days is still relevant and is included here.

The attraction to animal welfare was sufficient to draw me further into animal law. If I was to make any inroads on animal law I had to become a lawyer so I left the world of advertising in 1978 and enrolled at the University of Auckland. In 1983 I graduated with an honours degree in law and a bachelor's degree in arts focussing on political science and history.

At that time—the early 1980s—animal law was not a topic taught at any law school; there were no professors of animal welfare; the first appointment to the first chair in animal welfare was Donald Broome, at Cambridge University in 1986; and the animal liberation movement did not exist although Peter Singer had published Animal Liberation in 1975. The animal liberation movement was later founded in Australia and then the rest of the world based on the tenets of Singer's work.

Despite there being no Animal Law course I made up my own by combining criminal law, advanced criminal law, environmental law, administrative law, and advanced administrative law. My honours dissertation in 1983 was entitled: The Moral Status of Animals: Reform of Animal Protection Law.
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I am grateful to my enduring and ever supportive family—Ben and Liz, and Marc and Amy—who forwent materials is acknowledged.
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Craig Macalister BCA is the New Zealand Institute of Chartered Accountants’ Tax Director, and was formerly KPMG’s National Tax Director. Craig has over 20 years’ experience in tax, and has a strong tax technical and research background. Before joining KPMG, he held a number of senior positions within Inland Revenue, including the Department’s Policy Advice Division. Craig is the New Zealand Institute of Chartered Accountants’ representative on the Rewrite Advisory Panel, and co-author of the SMART tax *Income Tax Commentary* and *The Income Tax Act 2004: The New Rules*. In May 2010 Craig was appointed a member of the GST Advisory Panel set up to help businesses and the Government with the implementation of the GST increases.
User Information

Features
The Staples Tax Guide 2012, 72nd edition, is set out in alphabetically listed topics. The following features will help you find the information you need:


Quick Find
For ease of use, frequently referred to topics are listed below:

- **Binding rulings:** See 3000 for a list of current rulings and their location.
- **Cases:** See Indexes for case names and their location.
- **Depreciation rates:** See 5000.
- **Legislation:** See Indexes for comparative section references between the current and former Revenue Acts and their location.
- **Tax calendar:** See 2000 for important returns and payments.

Abbreviations

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<td>Accident Rehabilitation and Compensation Insurance</td>
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<td>ATV</td>
<td>adjusted tax value</td>
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<td>branch equivalent</td>
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<td>variable principle debt instrument</td>
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<td>Work and Income New Zealand</td>
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<td>working for families</td>
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<td>yield to maturity</td>
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The terms **Note**: or **TaxNote**: as used throughout the text indicate pending legislative changes, or particular points that should be taken into account by the reader.

**Queries?**

If you have any queries regarding this product or other Brookers products, contact our Customer Care Team on **0800 10 60 60** or email **service@thomsonreuters.co.nz**.
Recent Developments

Canterbury Earthquake Amendments

The substantive depreciation recovery income/loss on disposal provisions have been amended as a consequence of the Canterbury earthquakes.

The main issues covered by the amendments discussed below are:

• When the depreciation disposal rules apply;
• The deductibility of a loss when a building is not destroyed by an event beyond the owner’s control, but has to be subsequently destroyed as a consequence of such an event;
• Timing of recognition of income from business interruption insurance;
• Timing of recognition of depreciation recovery income; and
• Depreciation recovered income and roll-over relief.

An amendment also provides similar roll-over relief when insurance receipts are received for buildings held on revenue account and it is planned that they are to be replaced.

The amendments all came into force on 4 September 2010.

When the depreciation disposal rules apply

Section EE 47 defines certain “events” that trigger the depreciation disposal rules. Section EE 47(4) previously referred to an event that is the irreparable damage of an item of property. This now refers to:

(a) The irreparable damage of an item of property that is not a building or grandparented structure; or
(b) The damage of an item of property that is a building or grandparented structure, or of the neighbourhood of the building or grandparented structure, causing the building or grandparented structure to be:
   (i) useless for the purposes of deriving income; and
   (ii) demolished or abandoned for later demolition.

The effect of the amendment has been to broaden the events that trigger the depreciation recovery/loss on disposal rules.

Note: it need not be the owner of the building that demolishes the building.

Losses on buildings

Section EE 48 is the provision that deems depreciation recovery income to arise when the consideration for an item of depreciable property exceeds its adjusted tax value. Similarly, it deems an amount of depreciation loss when the consideration is less than the adjusted tax value.

However, for buildings, losses on disposal were only available when the building was irreparably damaged and rendered useless as a consequence of an event beyond the control of the owner. Losses on disposal of a building could not be claimed if an event beyond the control of the owner did not irreparably damage the building, but nonetheless the building still had to be destroyed as a consequence.

An amendment to s EE 48(3)(a) allows a deduction for an amount of depreciation loss when a building or grandparented structure has been rendered useless for the purposes of deriving income; and the building or grandparented structure is demolished or is awaiting demolition as a result of damage to the building or grandparented structure itself or to the neighbourhood of the building or grandparented structure.

The deduction is available when the damage is caused by a natural event that is not under the control of the person, an agent of the person or an associated person. The deduction is not permitted if the damage is caused as a result of the action or failure to act of the person, an agent or an associated person.
Recent Developments

**EXAMPLE:**

ABC syndicate owns a small office block with shops on the street front. The building itself survived the earthquakes. However, it is no longer able to be occupied as it is in the red zone and is due for demolition. The building is deemed to have been disposed of in terms of the amended s EE 47(4) for the consideration amount in s EE 45(8) and consequently any gain or loss on sale is triggered. Section EE 48(3)(a) will allow any loss on disposal.

**Timing of recognition of income from business interruption insurance**

A new rule has been inserted to govern the timing of recognising income arising from business interruption insurance. The new rule is in s CG 5B and provides that the part of the insurance, indemnity or compensation attributable to income that the person would have received but for the event, is income of the person in the earlier of the income year in which the amount is received or the income year in which the amount is reasonably able to be estimated.

**Timing of recognition of depreciation recovery income**

A provision is inserted in s EE 48(2B) to modify when depreciation recovery income arises. The amendment deems the income to arise in the income year that is the earliest income year in which the consideration (insurance proceeds/compensation) can be reasonably estimated. This provides relief from the previous position that gave rise to this income in the income year in which the event that gave rise to the depreciation recovery income occurred.

The amendment will assist in getting a better match between the receipt of the insurance proceeds and its recognition as income for tax purposes under the depreciation recovery rules when assets have been destroyed as a consequence of the earthquake.

**Note:** The amendment will require a further amendment to ensure that it also applies for the purposes of recognising a depreciation loss. That is, as drafted it only applies when a person derives depreciation recovery income.

**Depreciation recovered income and roll over relief**

Section EX 23B is inserted to provide roll-over relief from depreciation recovery income when it is intended to replace an asset after an amount of insurance or compensation is received in respect of an item of depreciable property. This depreciation recovery income would otherwise be taxable. The intention is that the depreciation recovery income reduces the tax value of the replacement asset.

The criteria for suspending the depreciation recovery income are:

- The section applies for income years prior to the 2016-17 income year; and
- When the person receives insurance or compensation for items of depreciable property that, as a result of the Canterbury earthquakes:
  - In the case of an item of property that is a building or grandparented structure, is rendered useless for the purpose of deriving income, and is demolished or abandoned for later demolition because of damage to the building or grandparented structure or because of damage to the neighbourhood of the building or grandparented structure; or
  - In the case of other depreciable property, the property is irreparably damaged; and
  - In the absence of s EZ 23B the person would have net depreciation recovery income from the insurance or compensation received. In this regard, the depreciation recovery income is measured on a class of depreciable property basis (not item by item) as set out in s EZ 23(10)(b).

If the above requirements are met, the person must plan to acquire property to replace the affected property to suspend the depreciation recovery income. Requirements for the replacement property are set out in s EZ 23B(7).

Finally, the person must give written notice to the CIR to suspend the depreciation recovery income specifying the depreciable property and linking that property to one of the defined classes. Sections EZ 23B(9) and (10) contains rules on when the notice is required to be furnished.
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**Note:** Importantly, a notice given under s EZ 23B(9) to suspend depreciation recovery income must be given in the year in which the income arises (referred to as the estimate year) and each subsequent income year until the affected property is replaced. Failure to give this notice means that the depreciation recovery income is no longer suspended. Thus, it is very important to have regard to the timing rules for filing the notice of election.

**Depreciation recovery income suspended**

If the above requirements are met, depreciation recovery income is suspended for the affected class of depreciable property. The classes of property are set out in s EZ 23B(10).

The amount of suspended depreciation recovery income is reduced when a person acquires an item of replacement property and links the replacement item with the affected property (that is the property in respect of which the insurance recovery was received).

If a person chooses not to replace all affected property, or the cost of the replacement property is less than the affected property then depreciation recovery income in respect of those assets will still be present under s EZ 23B(2) and (4)(b).

**Cost of replacement property**

When the cost of the replacement property equals or exceeds the cost of the affected property, the cost of the replacement property for tax depreciation purposes is reduced by the amount of suspended depreciation recovery income linked to that building.

**EXAMPLE 1:**

A building that cost $3 million and has an adjusted tax book value of $2 million is located in a red zone and due for demolition. The insurance proceeds are $6 million. The taxpayer files a notice of election under s EZ 23B(9) to defer the depreciation recovery income pending replacement. The building is replaced in the taxpayers 2014-15 year. The cost of the replacement building is $6 million. The $1 million suspended recovery income reduces the depreciable value of the building to $5 million. While of course the depreciation rate is zero per cent, the reduction in value will be taxable as depreciation recovery income if the building is subsequently sold at or above its $6 million cost.

**EXAMPLE 2:**

A machine that cost $1 million and has an adjusted tax book value of $700,000 is destroyed as a consequence of an earthquake in Canterbury. The asset is replaced in the 2013-14 year at a cost of $800,000. The formula in EZ 23B is:

\[
\frac{800,000 \times 300,000}{1,000,000}
\]

This gives $240,000 suspended depreciation recovery income which is rolled into the value of the replacement machine. The replacement machine has an adjusted tax book value of $560,000. As the value of the asset replaced was less than the affected asset, $60,000 suspended depreciation recovery income will be taxable in the year in which the asset was replaced under s EZ 23B(4)(b).

**Requirement for replacement property**

To be replacement property, the property must be depreciable property (not intangible depreciable property) that is acquired on or before the person’s 2015-16 income year. The property must also be included in the same category under s EZ 23B(10) as the affected class and be located in the greater Christchurch area, as defined in the Canterbury Earthquake Recovery Act.

**Amount of depreciation recovery income**

A person will have depreciation recovery income in an income year equal to the amount of suspended depreciation recovery income for the affected property and an income year:

- If the person decides not to acquire replacement property; or
- If the person becomes bankrupt or is liquidated; or
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- The end of the 2016-16 income year is reached and an amount of suspended depreciation recovery income remains.

**Consequential amendment to s EE 44**

A consequential amendment has been made to s EE 44 to ensure that it does not apply when items of depreciable property are destroyed by the earthquake and an amount of insurance is received to which s EZ23B applies. Recall, s EE 44 is the general provision that triggers application of the depreciation recovery rules.

As the amendment to s EE 44 only applies when the rule in s EZ 23B applies, insurance recoveries not covered by s EZ23B will be subject to the normal rules.

**Section CZ 23 Insurance compensation for buildings replaced as revenue account property affected by Canterbury earthquakes**

Section CZ 23 is a sister provision to s EX 23B, only it deals with revenue account property that is a building, as opposed to property of all types held on capital account.

Depreciation has not been available for building held on revenue account. Thus, there is no issue with depreciation recovery income in theory. What s CZ 23 aims to do is provide roll over relief for the insurance/compensation received that would otherwise be taxable income when the building is replaced.

The criteria for the roll-over relief are:

- The section applies for income years prior to the 2016-17 income year; and
- The person receives insurance or compensation for a building that is revenue account property that is rendered useless for the purpose of deriving income, and is demolished or abandoned for later demolition because of damage to the building or because of damage to the neighbourhood of the building; and
- In the absence of s CZ 23, the person would have net income from the insurance or compensation received under s CG 6 that exceeds the deduction for the cost of the property under s DB 23; and
- Plans to acquire property to replace the affected property and gives written notice to the CIR by 31 January 2012 or a later date set out in ss CZ 23(6) and (7).

If met, the amount of income arising under s CG 6 is not taxable income of the person. Further, the value of the building for the purposes of s EA 2 is reduced by the formula in s CZ 23(3).

There are rules in s CZ 23(4) that require the replacement property to be a building that is revenue account, acquired in or before the person’s 2015-16 income year, and located in the greater Christchurch area.

If the building is not replaced by the end of the 2015-16 income year or the person decides not to replace the building, or the person goes into liquidation or bankruptcy then the suspended income will be liable to tax.

**Note:** There are detailed requirements in ss CZ 23(6) and (7) for notices of election that must be met in order for the provision to apply. Importantly, a notice given under s CZ 23(6) to suspend recovery income must be given each year that it is necessary to suspend the income. Failure to give this notice means that the recovery income is no longer suspended. Thus, it is very important to have regard to the timing rules for filing the notice of election.

**Family Assistance**

A law change has confirmed that payments to relieve the adverse effects of emergency events such as the Canterbury earthquakes are not included in a person’s family scheme income [see 420.62].

**Foreign workers in Canterbury**

Interest relief on tax obligations relating to certain foreign workers assisting in the recovery from the Canterbury earthquakes is now in place. When foreign workers stay in New Zealand for more than a given period, tax obligations relating to PAYE withholding and provisional tax are backdated to the first day of presence in New Zealand. The backdating often means that payments of tax are overdue. Previously, interest
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was imposed on the overdue tax, but this is inappropriate in the circumstances. A new section required the CIR to cancel the liability to pay the interest. The relief is available for payments of tax due after 4 September 2010 and periods ending on 4 September 2011 at the latest.

Penalties and interest

The Canterbury earthquake of 4 September 2010 and its aftershocks have been declared an emergency event for the purposes of interest remission under s 183ABA of the TAA [see 1110.342]. Interest charged to non-residents working in the Canterbury earthquake recovery programme on overdue PAYE and provisional tax instalments will be cancelled during the period 5 September 2010 to 3 September 2011 inclusive [see 1110.343].

Tax credits

The period during which redundancy payments qualify for the six per cent redundancy payment tax credit has been extended from 31 March to 30 September 2011 [see 1395.90].

Assessments

The rules relating to the time bars for amending income tax and GST assessments have been changed from 29 August 2011, with the effect that if a taxpayer successfully challenges a CIR’s refusal to accept a late notice, the four-year period is extended by the amount of time it takes for the TRA or Court to finally decide the matter [see 60.80, 60.90].

Charities

A number of recent court decisions have clarified the meaning of “charitable purpose” [see 150.40]:

• A trust set up to teach biblical financial principles, by offering a scheme enabling members to pool their financial resources and obtain interest-free housing loans, had a charitable purpose in that it advanced religion and existed for the public benefit: Liberty Trust v Charities Commission, HC WN, CIV 2010-485-000831, 2 June 2011.
• Greenpeace was denied charitable status because its non-charitable activities, consisting of non-violent but potentially illegal activities such as trespass, were more than merely ancillary to its charitable purposes. See Re Greenpeace of New Zealand Incorporated HC WN CIV 2010-485-829, 6 May 2011.
• A trust established to protect and promote democracy and natural justice in New Zealand was held not to be a charity because its purposes were not exclusively charitable: Re Draco Foundation (NZ) Charitable Trust, CIV 2010-485-1275, 15 February 2011.
• The New Zealand Computer Society was held not to be a charitable entity because its purposes were not exclusively charitable. Its functions as a professional society, which are not charitable, constitute an independent purpose: Re New Zealand Computer Society Inc, CIV 2010-485-924, 28 February 2011.

Child support

For the year ended 31 March 2012, the maximum amount of taxable income of the liable parent on which child support is calculated has increased from $120,463 to $121,833 [see 160.60] and the minimum amount of child support payable by a liable parent has increased from $815 to $848 [see 160.80]. The CIR has released a standard practice statement explaining how the CIR’s discretion will be exercised when liable parents seek to pay overdue child support debt by instalment [see 160.60].

Depreciation

From the 2011–2012 income year, no depreciation can be claimed on buildings with an estimated useful life of 50 years or more [see 250.240]. However, new rules have been introduced to enable commercial building owners, who did not previously identify and depreciate building fit-out when they acquired a building, to amortise 15 per cent of the building’s adjusted tax value on a straight line basis over 50 years [see 250.340].
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The CIR has published an interpretation statement on the meaning of the term “obsolescence”, in relation to an asset’s estimated useful life. Obsolescence involves a reduction in the period for which an asset might be expected to be useful in deriving assessable income for reasons such as economic, technological or other external causes that affect the estimated useful life of the item. The statement includes a list of factors that may cause an asset to become obsolete. It also includes examples of factors that are not considered to be related to obsolescence (eg, a decision to scrap an asset) [see 250.230].

The CIR’s position on the deductibility of unsuccessful software development costs has changed. With effect from the start of the 2011–2012 income year, the CIR will not allow a deduction for expenditure on software development if the software is never used in the taxpayer’s income-earning process [see 250.410].

A new asset category – fleet tracking units – has been added to the transportation asset category with effect from the 2010–2011 income year [see 5000.30].

The asset descriptions of motor vehicles used for short-term hire have been amended to make it clear that short-term hire means a period of one month or less [see Transportation asset category in 5000.30].

Disputes and challenges

With effect from 29 August 2011:

• The small claims jurisdiction of the Taxation Review Authority (TRA) has been abolished [see 260.25, 260.125, 260.150].

• If the CIR rejects a taxpayer-initiated notice of proposed adjustment (NOPA) to an assessment, the taxpayer may now only challenge the assessment if the CIR has issued a “challenge notice”. If the CIR fails to issue a challenge notice within the prescribed four-year period, the CIR is deemed to accept the proposed adjustment. The CIR can apply to the High Court to issue a challenge notice outside the four-year period in exceptional circumstances [see 260.10, 260.40, 260.45, 260.50, 260.67, 260.70].

• The CIR now does not have to issue a NOPA before making an assessment if the assessment extinguishes a taxpayer’s tax loss [see 260.20].

• If the CIR decides not to grant an extension of time for a taxpayer to file a notice of response, a NOPA or a statement of position because of exceptional circumstances, the CIR must issue a “refusal notice” within one month. The disputant may challenge the refusal notice [see 260.50].

• The CIR is required to issue a statement of position (SOP) in response to a disputant’s statement of position if the CIR was not required to issue one when issuing a disclosure notice [see 260.55].

• The evidence exclusion rule has been relaxed so that it limits the taxpayer and the CIR to the issues and propositions of law disclosed in their respective SOPs. Previously it also applied to facts and evidence disclosed in the SOPs [see 260.100].

Double Tax Agreements

The double tax agreement between New Zealand and Turkey came into force on 28 July 2011 [see 310.187].

The double tax agreement between New Zealand and Hong Kong came into force on 9 November 2011 [see 310.92].

The withholding tax rate on royalties paid between residents of New Zealand and Chile has been reduced (retrospectively) from 10 per cent to five per cent from 1 May 2010 [see 310.60].

The withholding tax rate on dividends paid between residents of New Zealand and Mexico has been reduced (retrospectively) from 15 per cent to either five per cent or zero from 1 May 2010 [see 310.127].

Duties and levies

Gift duty has been repealed. No gift duty is payable on gifts made on or after 1 October 2011 [see 315.10].
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Employment relationship

The CIR’s interpretation guideline on whether a person is an employee or an independent contractor has been updated to take into account recent case law, particularly Bryson v Three Foot Six Ltd [see 335.20].

Family assistance

As an anti-avoidance measure, the definition of family scheme income has been widened from 1 April 2011 to include:

- The undistributed income of a trust of which the person is a settlor;
- The taxable value of attributable fringe benefits, and the corresponding fringe benefit tax, of major shareholders;
- Deposits into the person’s main income equalisation account;
- Half of certain pensions and annuities;
- Investment and beneficiary income of dependent children, in excess of $500;
- Non-residents’ foreign-sourced income of the person’s spouse, civil union partner or de facto partner;
- Certain other receipts used to replace lost income or to meet living expenses [see 420.60].

A law change has confirmed that payments to relieve the adverse effects of emergency events such as the Canterbury earthquakes are not included in a person’s family scheme income [see 420.62].

The prescribed amounts for the family tax credit have been increased for the year ended 31 March 2012 [see 420.25].

The minimum family tax credit has been increased to ensure a minimum family scheme income of $22,204 for the year ended 31 March 2012.

Financial Relief

The CIR’s practice for providing financial relief by way of instalment arrangements has been revised. The new practice applies from 16 February 2011 [see 480.35].

Fringe Benefit Tax

The prescribed interest rate for low interest loans fell from 6.24 per cent to 5.90 per cent from the quarter starting 1 April 2011 [see 540.135].

Benefits provided to employees to give them relief from the adverse effects of the Canterbury earthquakes in September 2010 and February 2011 are not subject to fringe benefit tax [see 540.200, 540.257].

For the year ended 31 March 2012, the rate of FBT under the single rate option is 49.25 per cent for all four quarters and, under the alternate rate option, employers can choose between 43 and 49.25 per cent for each of the first three quarters [see 540.280, 540.315].

The rates used to calculate FBT on attributed fringe benefits have dropped for the year ended 31 March 2012 in line with the lower income tax rates [see 540.300].

GST

New definitions of “dwelling” and “commercial dwelling” apply from 1 April 2011 [see 580.20, 580.24].

From 1 April 2011, zero-rating applies to most supplies of land by a registered person to another registered person who intends to use it in carrying on a taxable activity [see 580.49].

From 1 April 2011, the application of the reverse charge mechanism is based on the intended and actual use of the imported service in the making of taxable supplies. Previously it was based on the type of supplies made by the importer’s business [see 580.101].

Where a purchaser nominates another person (a nominee) to be the recipient of the goods and services, special rules apply. The GST treatment depends on whether both the contractual purchaser and the nominee are both registered or not registered or whether one is registered and the other is not. The new treatment applies from 1 April 2011 [see 580.123].
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From 1 April 2011, new apportionment rules apply to the adjustments for partial taxable or non-taxable use of assets. The new rules apply to assets acquired on or after 1 April 2011. They also apply where a person registers for GST on or after 1 April 2011 and uses goods and services that they previously acquired for making taxable supplies after the date of registration [see 580.125].

**GST input tax credit claims on goods and services acquired before 1 April 2011**

A technical error in the GST changes enacted in December 2010 meant that there was an inability to claim input tax credits on goods or services acquired or produced before 1 April 2011 that were not at that time acquired or produced for making taxable supplies, but were used for that purpose from 1 April 2011.

A transitional provision (section 21HB) has been added to the legislation to allow a registered person to claim an input tax credit to the extent a claim has not been made under the input tax credit rules that applied before the December 2010 amendments. The goods or services are treated as having been acquired on 1 April 2011 at the original cost of the supply.

Note that the new section targets supplies made on and after 1 April 2011 that are taxable as a result of the changes to the definitions of “dwelling” and “commercial dwelling”. While the change in definitions contributed to the issue, other situations may arise that also produce the same unintended outcome.

The amendment came into effect on 29 August 2011 and is retrospective, applying to supplies made on or after 1 April 2011 [see 580.126].

**Income from New Zealand and foreign sources**

The method of calculating the amount of New Zealand tax relating to each segment of foreign-sourced income, when determining the maximum foreign tax credit allowed, has been clarified [see 760.45].

**KiwiSaver**

The CIR is now required to take a number of additional factors into account when considering an application for a refund of KiwiSaver contributions due to financial hardship as a result of the Canterbury earthquakes [see 860.95].

From 1 July 2011, the maximum member tax credit has been halved from $1,042.86 to $521.43 a year, and the rate at which the credit is paid is reduced from $1 to 50 cents for each $1 contributed by members [see 860.135].

With effect from 29 August 2011:

- The rules relating to the operation of the KiwiSaver holding account by the CIR have been revised [see 860.75].
- When a member transfers to a new KiwiSaver fund provider, the CIR can pay the member tax credit to the new fund provider. Previously the old fund provider had to request that the credit be paid to the new provider [see 860.140].

There have been some changes to the list of default KiwiSaver schemes [see 860.55].

**Look-through companies**

The look-through company regime applies for income years commencing on or after 1 April 2011. A look-through company is transparent for tax purposes. Income, expenses, gains, losses, tax credits and rebates pass through to the shareholders and are taxed at the shareholders’ marginal tax rates. Some tax matters are dealt with at the company level such as GST, PAYE and other withholding taxes and matters related to the amalgamated companies regime [see 920].

**Motor vehicles**

The rate for calculating the business-use expenditure of a motor vehicle when business travel is 5,000 kilometres or less a year has increased to 74 cents per kilometre for the 2011 income year (previously 70 cents per kilometre) [see 990.65].
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Non-residents and absentees
From 1 April 2011:

- The circumstances in which an excess debt entity must apportion its interest expenditure under the thin capitalisation rules have been amended; and
- The default percentage that may be used as the debt percentage of the worldwide group of an excess debt entity has been changed [see 1000.90].

Payment and collection of tax
From 29 April 2011, IRD has revised its practice on the use of deduction notices to require banks to make deductions from their customers’ accounts [see 1100.22].

From 29 August 2011:

- The CIR is able to offer taxpayers the ability to pay their tax by credit or debit card. A 1.42 per cent fee is payable for this service [see 1100.17].
- The CIR can seize tax pooling deposits by means of a deduction notice [see 1100.20].

Penalties and interest
The Canterbury earthquake of 4 September 2010 and its aftershocks have been declared an emergency event for the purposes of interest remission under TAA s 183ABA [see 1110.342].

From 29 August 2011 the absolute liability, knowledge, and evasion or similar offences have been amended by removing reference to the requirement to keep “books”. These offences now simply refer to failing or knowingly failing to keep the documents (previously books and documents) required to be kept by tax law. A definition of the term “document” has also been inserted in the TAA [see 1110.225, 1110.230, 1110.235].

Interest charged to non-residents working in the Canterbury earthquake recovery programme on overdue PAYE and provisional tax instalments will be cancelled during the period 5 September 2010 to 3 September 2011 inclusive [see 1110.343].

QCs and LAQCs
The rules governing qualifying companies and loss attributing companies have been changed with effect from the year commencing 1 April 2011. The changes were announced in the 2010 Budget, and were enacted by way of a supplementary order paper to the Taxation (GST and Remedial Matters) Act 2010.

Existing qualifying companies (QCs) and loss-attributing qualifying companies (LAQCs) are able to continue to use the current QC rules, but without the ability to attribute losses, pending a review of the dividend rules for closely held companies. Companies that are not already QCs are unable to enter the QC regime from 1 April 2011.

A new regime is introduced, called “look-through companies”. Existing QCs and LAQCs are able to transition into the new regime or change to another business model, such as a partnership or sole trader, without a tax cost, during the period 1 April 2011 to 31 March 2013.

A special report summarising the changes is available on Inland Revenue’s Policy Advice Division website: www.taxpolicy.ird.govt.nz.

Student loans
The CIR has issued a standard practice statement on granting relief from student loan repayments on the grounds of serious hardship [see 1380.15].

The Student Loan Scheme Act 1992 has been replaced by the Students Loan Scheme Act 2011 from 1 April 2012. The objectives of the new act are to make it easier for borrowers to manage their loans and to pay back what they owe, and to encourage earlier repayment of loans. The act does not introduce any significant policy changes [see 1380.10 to 1380.70].
**Student Loan Scheme Act 2011**

The Student Loan Scheme Act 2011 reforms the way student loans are repaid, the way borrowers can manage their loans, and the way loans are administered. It also rewrites the current student loan legislation.

This Act replaces the Student Loan Scheme Act 1992, and generally applies from 1 April 2012. Its main purpose is to make it easier for borrowers to manage their loans, pay back what they owe, and encourage earlier repayment. It is not intended as a wider review of student loan scheme policy. The Act also contains a number of minor miscellaneous amendments.

**Moving borrowers to an electronic environment**

**Electronic administration of the student loan scheme**

The changes mean that borrowers will be able to manage their loan accounts by interacting electronically with Inland Revenue. As well as having online access to up-to-date loan information, borrowers will be able to communicate electronically with Inland Revenue to manage their loans.

**Consolidated view of loan balance**

The following changes have been made:

- Inland Revenue will provide borrowers with a consolidated view of their total loan balance, removing the need to contact two agencies to obtain this information;
- The near real-time transfer of a borrower’s loan advance information and contact details from the loan manager to Inland Revenue. As loan advances are drawn down or borrowers’ contact details are changed, this information will be transferred to Inland Revenue to keep borrowers better informed of their loan details and obligations. Inland Revenue will inform borrowers of their total loan balance by providing them with access to viewing their loan on an internet site; and
- The sharing of information between the loan manager and Inland Revenue on people applying for student loans: to confirm the applicant’s identity, and to prevent fraud and ensure loans are assigned to the correct borrowers.

**Informing and notifying borrowers**

The Act changes the way Inland Revenue communicates with borrowers. Specifically, Inland Revenue will:

- Communicate with borrowers electronically when an active email address is available;
- Make as many services as possible available electronically, to enable borrowers to self manage their loans; and
- Provide borrowers with personal access to information about their loan, via the Inland Revenue website.

The Act also introduces four new terms to refer to the different types of communication between Inland Revenue and borrowers:

- “Inform”: Inland Revenue provides information to the borrower in a passive way, typically by providing a website or physical service where borrowers can access relevant information, or by giving public notice.
- “Notify”: the borrower or Inland Revenue actively communicates information through a broad range of methods. This can be by paper, by telephone, in person, by electronic means, or by any other manner acceptable to the CIR. This method will be used when a degree of flexibility over the form of communication is appropriate because of the type of information required.
- “Notify a person in writing”: to communicate using the methods available in “Notify”, including by electronic means such as an email, but excluding in person or by phone. This form of communication will be used to communicate with borrowers in a formal way, when it is not appropriate for the information to be communicated in person or by phone.
- “Formally notify”: to communicate to borrowers in writing and on paper. Electronic communications are excluded from this definition.
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Changes will apply from 1 April 2012, while changes to the transfer of the consolidated loan balance will apply from 1 January 2012.

**Methods of meeting repayment obligations**
The following changes take place from 1 April 2012.

**Pay-period repayment obligations**
The annual assessment process will be removed for salary and wages earners, who make up the majority of borrowers. Salary and wage earners will continue to have deductions made from that income for student loan repayments.

For the majority of borrowers whose income is mainly from salary or wages, the amount deducted for a pay-period will be the borrower’s final repayment obligation for that pay. This will provide certainty every payday that the repayment obligation has been met, and should result in reductions in overdue debt assessments, and compliance and administration costs.

**Unused repayment threshold transfer for secondary jobs**
Student loan borrowers whose income is solely from salary or wages, who have two or more jobs at the same time, and whose income from their main job is under the repayment threshold, will be able to use any unused repayment threshold from their main job against their secondary jobs. Currently, deductions are made from a borrower’s main job at 10 per cent of each dollar of income over the pay-period repayment threshold, and at 10 per cent of each dollar of income from each of a borrower’s secondary jobs. If income from the main job is less than the repayment threshold, a borrower’s student loan repayments are higher than for someone for whom their income is from the one job.

**Salary and wage deduction exemption for full-time students**
Full-time, full-year, students who expect to earn under the annual repayment threshold will be able to apply for an exemption from student loan deductions. The exemption must be applied for in advance.

**Significant under- and over-deductions**
The Act contains amendments that allow the CIR to not take corrective action for under- and over-deductions of student loan repayments, unless the amounts are considered to be significant. The thresholds for taking action will be set by the CIR each year, and notified to borrowers. Borrowers will be able to request a refund for a significant over-deduction, and the CIR will be able to collect significant under-deductions from future salary and wages.

**Extra deductions from salary and wages**
The Act allows Inland Revenue (or a borrower) to ask employers to make additional student loan deductions from a borrower’s salary or wage, using a new “SLADR” tax code.

Borrowers may ask their employer to make extra deductions at an extra deduction rate, or of a specific amount. This may be because the borrower wishes to pay unpaid amounts, or to make excess repayments to reduce their loan balance, which may qualify for the 10 per cent excess repayment bonus. The CIR may require extra deductions if a borrower has not had enough deducted through the standard deductions.

**Special assessments**
The CIR will be able to make an assessment to determine the amount of deductions a borrower should have had deducted from their salary or wages, and which has not been collected through other means. Such assessments will be able to be made in relation to borrowers who earn salary or wage income, or salary and wage and pre-taxed income such as dividend or interest income.

The assessment will not be used for borrowers who are required to file a tax return (eg borrowers who have a mixture of salary and wages, and business-type income). These borrowers’ repayment obligations will be determined on an annual basis, as at present.
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Pre-taxed repayment obligations

The Act includes a separate loan repayment mechanism for borrowers who do not have to file a tax return, and who have pre-taxed income, such as income from interest or dividends, salary or wages from casual agricultural employment, or election day employment. These borrowers will now be required to make an online declaration of their pre-taxed income.

The new mechanism is designed to assess and collect repayments relating to income derived from sources that are not required to have student loan deductions made, when the borrower would not otherwise be required to declare that income for tax purposes as income tax has already been withheld from it.

The pre-taxed loan repayment obligation will apply to borrowers who earn $1,500 or more net pre-taxed income for a tax year, and whose combined income from net pre-taxed income and salary or wages for a tax year is $1,500 or more than the annual repayment threshold.

**EXAMPLE:**

Peter has salary or wage income of $30,000, which is above the repayment threshold of $19,084. Student loan repayment deductions are correctly made from his salary or wage income. Peter also earns $15,000 of interest income for the 2012-2013 tax year, and files his pre-taxed income declaration on 7 July 2013. Peter has made no payments towards his pre-taxed repayment obligation during the year. The CIR assesses Peter’s pre-taxed repayment obligation at $1,500, being 10 per cent of his interest income which is required to be paid in three remaining repayments on 28 August 2013, 15 January 2014, and 7 May 2014.

Peter will also be required to pay interim payments for the 2013-2014 tax year. Peter’s interim payments for the 2013-2014 year are 105 per cent of his pre-taxed loan repayment obligation for the 2012-2013 tax year: 105 per cent x $1,500 = $1,575 divided by the number of due dates.

His interim repayments are due on three dates, so one-third ($525) is due on each of the following dates: 28 August 2013, 15 January 2014, and 7 May 2014.

Alignment with provisional tax payment dates

The Act aligns the payment of interim payments for student loans with the provisional tax payment dates for borrowers who are required to file a tax return. Certain borrowers will also be allowed to pay, over a number of due dates, an outstanding loan repayment obligation for a tax year. The changes apply to borrowers required to file a tax return because, for example, they have business income.

Borrowers who have net income for a tax year that is more than the annual repayment threshold will have their “other income” repayment obligation for that tax year determined as follows:

Other income repayment obligation = [10 per cent x (Net income – annual repayment threshold)] – salary and wage deductions

**EXAMPLE:**

Helen has net income for the tax year of $42,000, comprising $30,000 in salary income and $12,000 from a rental property. The student loan deductions from her salary and wages amount to $1,000. Because Helen had income from a rental property, she is required to file a return of income for tax purposes. When she files her return of income, her other income repayment obligation is calculated as follows:

other income repayment obligation = [10 per cent x ($42,000 – $19,084)] – $1,000 = $1,291.60

**EXAMPLE:**

Jim has a March balance date, and is required to file his tax return by 7 July 2013. For student loan purposes, Jim has an “other income repayment obligation” of $800 for the 2012-2013 tax year. He will be required to pay his remaining repayment on 28 August 2013, which is his provisional tax date that follows 7 July 2013.

Interest and alignment of penalties with income tax rules

Overseas-based interest and late payment interest

The following changes have been made under the Act:

- StudyLink will cease to charge interest on student loans in the period before the loan is transferred to Inland Revenue;
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- Inland Revenue will only charge interest when borrowers are overseas-based;
- Overseas-based interest will be charged at the base interest rate, which is currently 6.6 per cent;
- The current late payment penalties of approximately 19.56 per cent per annum will be replaced by late payment interest, which will be set at the significantly lower rate of four per cent above the base interest rate (currently 6.6 per cent), giving a combined rate of 10.6 per cent per annum;
- The late payment interest rate will be reduced by two per cent if the borrower enters into an instalment arrangement; and
- Interest will not be charged if the unpaid amount is less than $500. In these cases, the unpaid amount will be added back to the loan balance.

Penalties and offences

The Act contains amendments that impose penalties for offences relating to the late or non-filing of information by borrowers, and aligns the imposition of both civil and criminal penalties for non-compliant activities with those that apply to other tax offences. Specifically, the Act introduces the following changes:

- Late filing penalties will be imposed for incomplete or absent declarations, or notifications in certain circumstances. The late filing penalty will be the same amount that applies for income tax purposes, depending on the borrower’s income. For example, the penalty imposed will be $50 if the borrower’s income is less than $100,000, $250 if the borrower’s income is between $100,000 and $1,000,000, and $500 if their income is over $1,000,000;
- Student loan shortfall penalties will be imposed at the same rate that would apply from taking an incorrect tax position. The student loan shortfall penalty will apply when a borrower has taken an incorrect tax position which is lower than the correct tax position and is also liable to pay a shortfall penalty for income tax; and
- Penalties for wilfully or negligently failing to provide information to Inland Revenue will be aligned with those for other tax types.

CIR may recall loans

A section has been inserted into the Act, the purpose of which is to give the CIR the authority to exercise any right or power in a student loan (whether or not the CIR is the lender under the agreement) to recall or demand repayment of all or any of the loan advance or loan balance. This measure is required because the Ministry of Education, the Ministry of Social Development, or StudyLink are the lender in many of the loans administered by Inland Revenue, rather than Inland Revenue.

Superannuation fund withdrawal tax

Superannuation fund withdrawal tax has been repealed and does not apply to withdrawals made on or after 1 April 2011.

Taxation (Tax Administration and Remedial Matters) Act 2011

Donee organisations

The following organisations have been added to the list of charities donations to which qualify for the charitable donations tax credit, with effect from the year ended 31 March 2013:

- Jasmine Charitable Trust No 2
- New Zealand Good Samaritan Heart Mission to Samoa Trust
- NZ-Iraqi Relief Charitable Trust
- RNZWCS Limited
- Ruel Foundation
- The Cambodia Charitable Trust
- The Unions Aotearoa International Development Trust [see 1395.75].
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**Gift duty abolition**

Gift duty is to be abolished for gifts made on or after 1 October 2011.

**Relaxing the taxpayer secrecy rules**

The secrecy rules contained in Part 4 of the TAA are amended. The previous rule allowing the CIR to release taxpayer information under the Inland Revenue Acts is replaced with the discretion to release taxpayer information in executing or performing the powers, duties and responsibilities of the CIR to administer, implement, improve, research, and reform the tax system. The change will allow the CIR more flexibility to release taxpayer information.

In deciding whether to exercise the discretion to release information, the CIR will have to consider the integrity of the tax system, the importance of promoting voluntary compliance, the resources available to him, the personal or commercial interest or sensitivity of the taxpayer concerned, and whether the information is currently in the public domain. The requirement to obtain Ministerial authorisation for the release of aggregate or process information will be removed. The release of this information will be at the discretion of the CIR, but subject to the criteria set out above.

The new rules also allow the CIR to respond when taxpayers make incorrect statements to the media about Inland Revenue, or about their dealings with Inland Revenue.

**Information sharing**

Changes to facilitate the sharing of tax information between Inland Revenue and other government agencies have also been made. This allows more efficient use of information collected by Inland Revenue, and reduces the need for individuals to provide the same information to more than one government agency.

The changes allow an Order in Council to be made, authorising the sharing of Inland Revenue information with another government agency, provided certain criteria are met. The government agency seeking access to the information must have the ability and authority to collect the information in its own right, and the information must be available and already collected by Inland Revenue. Information will only be shared if it is not so sensitive that it would inhibit individuals from providing accurate information in the future. It must also be economically inefficient for the agency seeking access to collect the information itself, or there must be clear compliance benefits to individuals for the information to be shared rather than collected separately.

**Disputes rules**

**Small claims jurisdiction of TRA**

The small claims jurisdiction of the TRA is removed. It has been used infrequently, and is not adequately fulfilling its policy intention. The general jurisdiction of the TRA is sufficiently flexible to deal with the any specific requirements of a dispute related to a small amount of tax.

**Evidence exclusion rule**

The evidence exclusion rule (EER) is relaxed so that it limits the parties only to the issues and propositions of law disclosed in their SOP.

In the event that a dispute reaches court, the EER currently limits the CIR and the taxpayer to the facts, evidence, issues, and propositions of law that are disclosed in their respective SOPs. The EER is amended so that it limits the parties only to the issues and propositions of law contained in the SOP, and not the facts and evidence. This change should mean that the parties still have considerable certainty on the scope of the dispute, while eliminating the pressure to include every fact and piece of evidence in the SOP for fear of not being able to raise them at a later date. The SOP will still need to contain an outline of the facts and evidence to be relied upon.
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Exceptional circumstances

Previously, a late notice from a taxpayer can be accepted by the CIR if exceptional circumstances exist. This rule is now expanded to allow the CIR to accept late documents if the taxpayer has a demonstrable intention to enter into or continue the disputes process. If the CIR does not exercise the discretion to accept late documents, that decision will be able to be challenged in the TRA.

Although statutory timeframes are considered essential to ensuring that the disputes process is completed in a timely and efficient manner, there will be situations when a late response is justified and the party to the dispute should not be unduly penalised for failing to meet a deadline. This is particularly the case for tax disputes, when it is considered that the consequence of late filing is that the party is deemed to accept the position of the other disputant.

In order to avoid a situation where taxpayers can extend the process indefinitely by continually asserting an intention to dispute without actually acting on that intention, the existing requirement that the disputant send the relevant notice to the CIR as soon as practicable after becoming aware of their failure to respond in time will remain.

A new provision is to be added so that the time bar for the substantive dispute is suspended while the appropriateness or otherwise of the CIR’s exercise of his discretion is considered by the courts.

Taxpayer right to opt out of disputes process

A new rule introduced removes the current right in s 138B(3) of the TAA that allows taxpayers to opt out of the disputes process during disputes they have initiated. This change ensures there is consistency in the process between disputes initiated by the CIR and those initiated by taxpayers. Complementary changes will ensure that the full process is followed by both parties unless a truncated process is agreed upon.

Taxpayers currently have a right to take to court a dispute they have initiated at any time after the CIR has issued the notice of response (NOR). This ability means that a dispute can be fast-tracked to court without having the benefit of a conference between the parties. There is also a significant information deficit in taxpayer-initiated disputes. These disputes, by their nature, often come as a surprise to the CIR. The CIR has two months to issue the NOR, after which the challenge can commence. The period between the receipt of the NOPA and the issuing of the NOR will not always be long enough for the CIR to form a definitive view on the issues raised, particularly in the limited cases where the taxpayer is uncooperative. This process has the potential for disputes to reach court without the issues being properly defined and debated between the parties — therefore defeating a key objective of the disputes process.

The new rule retains the taxpayer’s challenge right, but only in circumstances when the CIR has issued a “challenge notice” (as introduced in the Act) in respect of the dispute. This notice is the CIR’s final view that the assessment will not be amended in the way proposed by the taxpayer. It is anticipated that these notices will generally be issued by Inland Revenue once the dispute has been fully considered in the adjudication process.

The changes mean that the SOPs must be exchanged before the CIR issues an amended assessment or challenge notice. These changes ensure that, unless an exception applies (such as when the parties agree to opt out), the full process must be followed in both taxpayer- and CIR-initiated disputes. They also resolve an existing technical argument that the CIR does not have to issue a SOP in a taxpayer-initiated dispute.

A fast-track procedure for taxpayer-initiated disputes that are ancillary to other substantive disputes is to be introduced. This applies to disputes where the taxpayer has adopted a position across numerous tax periods, or when a taxpayer is affected by a position taken by another taxpayer. In these circumstances, the CIR can issue a challenge notice immediately, and the taxpayer can challenge the assessment in court.

TRA regulations

The TRA Regulations are updated in order to bring them into consistency with the District Court and High Court Rules.
Recent Developments

Tax pooling

The following changes to the tax pooling rules have been made:

• Taxpayers using a provisional tax pooling facility have 75 days (currently 60 days) from the terminal tax date to access funds held by a tax pooling intermediary to meet their provisional or terminal tax liabilities at backdated effective dates. This will provide more time for taxpayers with a December balance date to request a transfer from a pool before filing a return, in order to access pooling funds with a backdated effective date.

• The time limit to access funds will not apply for “own funds” provided the taxpayer is not overdue in filing their return for the tax year. Limits to the amount a taxpayer may request an intermediary to transfer are to be introduced. This restriction will not apply to taxpayers who use their own funds, except when the funds are used to meet an increased obligation or deferred tax.

• An amendment allows the CIR to seize tax pooling deposits by way of a deduction notice. The amendment clarifies that when a taxpayer has made a deposit and fails to instruct their tax pooling intermediary to transfer the deposit to meet their tax obligations, the concessions available for using tax pooling funds voluntarily will not apply. The amendment provides that, when a deduction notice is applied, the effective date is the date the tax pooling intermediary pays the funds to the CIR. Previously it could have been argued that the deposit date of the funds was the effective date.

• Previously the tax pooling rules only permitted tax pooling funds to be used to meet an actual tax obligation. Consistent with the policy intent, the funds transferred from the pool to a taxpayer’s own account is limited to the amount of tax actually owing. However, sometimes a taxpayer may wish to purchase tax pooling funds before they file their return for the relevant year, because they expect to have an obligation that they cannot quantify at that time. An amendment allows taxpayers to use funds in a tax pooling account towards the payment of a future tax liability if certain criteria are met. This section only limits the use of acquired funds; taxpayers who use their own deposited funds will not be subject to this limit.

• A new rule allows pooling funds to be used for a voluntary disclosure when there has not been a previous assessment, provided the relevant return has previously been filed for that year. Because not all adjustments will arise from a voluntary disclosure, pooling funds will be able to be used when the CIR makes an assessment or adjustment increasing an amount previously payable, provided the relevant return has previously been filed for that year or period. Any original amounts payable will not be able to be paid with tax pooling funds. Tax pooling funds can only be used for the adjustment resulting from the difference between the return filed and the increased amount owing. If second or subsequent adjustments are made that result in more tax to pay, the new rule also allows tax pooling to be used, provided each subsequent adjustment results in an increased amount of tax to pay than the immediately preceding adjustment.

• The Act introduces an amendment to require taxpayers purchasing funds in a tax pool to nominate an effective date that is no earlier than the original due date (or the first provisional tax due date, in income tax cases) of the applicable year or period in which the tax pooling funds are used. The change is required because provisional tax pooling rules previously included an unintended ability to use tax pooling funds to eliminate imputation account debit closing balances. This occurs when a taxpayer purchases or otherwise acquires pooling funds at an effective date that falls before the tax year in which the tax pooling funds are to be used to meet an income tax obligation. This effectively allows a company to receive a backdated effective date for imputation purposes, while paying a current provisional or terminal tax obligation.

• The revenue types that tax pooling can be used to pay are to be extended to include income tax, FBT, GST and imputation tax. The withholding taxes defined in “amount of tax” in the s YA 1 definition are also to be brought into the tax pooling rules. These measures better reflect the policy intent of which revenues and in what circumstances tax pooling can be used. The 10 per cent imputation penalty tax
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can also be met using tax pooling, to the extent that this relates to an increased amount of further income
tax payable following an assessment by the CIR.

Using credit cards to pay tax
From 1 July 2011, an amendment allowed the CIR to charge taxpayers a fee if they chose to pay their tax or
social liabilities by credit card. The fee, set at 1.42 per cent of the total transaction, will not apply to overseas-
based student loan borrowers and overseas-based child support liable parents who choose to make their
payments by credit card.

Dividends paid within a wholly-owned group
At present, in order for a dividend paid by one company to another within a wholly-owned group to be exempt
under s CW 10, the companies must satisfy a common balance date requirement. This requirement is to be
removed for dividends derived by a company on or after the first day of that company’s 2010-2011 income
year.

Portfolio investment entities (PIEs)
Two new categories of PIE have been introduced.
The first category invests only in foreign-sourced income earning assets, although there is a de minimis five
per cent allowance for New Zealand sourced interest and one per cent for New Zealand shares. Non-resident
investors in this category of PIE are taxed at zero per cent.
The second category can invest in both New Zealand and foreign-sourced income earning assets. The tax
rates applying to non-resident investors reflect the rates that they would pay if they had made a direct
investment in those assets.

Non-resident investment in PIEs
The Act introduces changes relating to the treatment of non-resident investment in PIEs. These changes are
intended to ensure that non-resident investors in PIEs are taxed in a similar way on their PIE income as if
they invested directly. Certain multi-rate PIEs can now choose to become foreign investment PIEs and treat
their notified foreign investors as having either a prescribed investment rate of zero per cent (if the PIE earns
only foreign-sourced income), or a variable rate that depends on the income source or investment type of the
income they earn (if they earn both foreign-sourced income and other amounts).

Remedial matters
The Act also addresses a number of minor remedial matters. These include:
• Allowing building societies to use the amalgamation tax rules for companies;
• Giving trustees the choice of substituting money for RWT credits in beneficiary income;
• Giving relief when a forestry right is extinguished and re-granted in whole or in part solely for the
  purpose of facilitating a Treaty of Waitangi claim settlement process;
• Allowing employers the choice of a flat 33 per cent rate of employer superannuation contribution tax
  for contributions to defined benefit funds; and
• Ensuring that the elections and methods used for tax of a qualifying company are correctly dealt with
  when the qualifying company transitions into a look-through company.

Tax credits
The period during which redundancy payments qualify for the 6% six per cent redundancy payment tax credit
has been extended from 31 March 2011 to 30 September 2011 [see 1395.90].
The following organisations have been added to the list of charities donations to which qualify for the
charitable donations tax credit, with effect from the year ended 31 March 2013:
• Jasmine Charitable Trust No 2;
• New Zealand Good Samaritan Heart Mission to Samoa Trust;

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- NZ-Iraqi Relief Charitable Trust;
- RNZWCS Limited;
- Ruel Foundation;
- The Cambodia Charitable Trust;
- The Unions Aotearoa International Development Trust [see 1395.75].
Future Developments

Depreciation
From the 2011-2012 income year, no depreciation can be claimed on buildings with an estimated useful life of 50 years or more [see 250.100].

New rules have been introduced with effect from the 2011-2012 income year to enable commercial building owners, who did not previously identify and depreciate building fit-out when they acquired a building, to amortise 15 per cent of the building’s adjusted tax value on a straight line basis over 50 years [see 250.103].

Double tax agreements
The double tax agreement between New Zealand and Hong Kong is expected to enter into force by the end of 2011 [see 310.40].

Taxation (International Investment and Remedial Matters) Bill
TaxNote: At the time of publication of the Staples Tax Guide 2012, 72nd edition, the Taxation (International Investment and Remedial Matters) Bill had not been passed into law. It is anticipated that the content of Staples Tax Guide will be changed following the passing of the Bill. When enacted, these changes will also be available in the Staples Tax Guide online at www.brookersonline.co.nz. The changes will also be included in the Staples Tax Guide 2012 - Mid-Year Supplement.

Foreign Investment Fund Rules for non-portfolio FIF interests
From the 2007-08 year significant changes were made to the FIF rules for calculating income from less than 10 per cent shareholdings in foreign companies (portfolio foreign investment funds). As a consequence, many investors were exposed to the FIF rules for the first time. Investors generally calculated FIF income based on the fair dividend rate method, which applies an assumed five per cent return on the market value of their aggregate taxable FIF interests, although a natural person and trustees of family trusts can choose to be taxed on the actual returns of all of their foreign portfolio investments (although any losses are reduced to zero) by using the comparative value method for that year. The portfolio FIF rules are contained in 850.130–850.290.

With the changes to the portfolio rules, the non-portfolio rules were essentially left unchanged and the FIF income calculation methods remained the same, with the comparative value method the generally applied method.

The Taxation (International Investment and Remedial Matters) Bill introduces a new suite of rules to tax interests in non-portfolio FIFs. The key features are the removal of the grey list and an extension of the active income exemption, which was introduced in 2009 for offshore subsidiaries that are controlled foreign companies, so that joint ventures and other significant shareholdings in foreign companies are now treated similarly.

The CFC reforms were designed to ensure that New Zealand businesses that expand offshore by operating subsidiaries in foreign countries can compete on an even footing with foreign competitors operating in the same country.

The Taxation (International Investment and Remedial Matters) Bill aims to provide consistency of tax treatment with the CFC rules. It achieves this by extending the active income exemption, with some modifications, to non-portfolio FIFs. It also extends the portfolio FIF income methods to non-portfolio investors unable to use the active income exemption due to having an insufficient shareholding or access to information. These investors will be taxed under the fair dividend rate or cost methods. An exception is available for non-portfolio FIFs that are resident and subject to tax in Australia. This is consistent with the CFC reforms that replaced the eight-country grey list exemption with an exemption for CFCs that are resident...
and subject to tax in Australia, and with the portfolio FIF rules that exempt ASX-listed Australian resident companies.

Changes have also been made to the portfolio FIF calculation methods, and are discussed in more detail under Changes to FIF Income Calculation Methods below.

The new rules apply for income years commencing on or after 1 July 2011, which for many will be the income year commencing 1 April 2012.

**Income calculation methods for non-portfolio FIFs**

The FIF calculation methods that can be used to calculate FIF income from interests in non-portfolio FIFs are:

- The new active income method;
- The fair dividend rate method;
- The cost method; and
- If the investor is a natural person or trustee of a family trust, the comparative value method.

**Attributable FIF income method [s EX 50]**

The new method for calculating FIF income and loss from non-portfolio FIF interests is based on the method used for calculating attributed CFC income [see 850.40–850.90].

This new method, referred to as the attributable FIF income method, replaces the branch equivalent method. Under this new method investors in the FIF generally calculate their FIF income as though the FIF were a CFC using the active income exemption. This is the same approach the branch equivalent method took; that is, in calculating the branch equivalent income or loss of a FIF, the CFC rules were read as though the FIF were a CFC.

No income is attributed from FIFs that satisfy the active business test, either independently or as part of a consolidated group of FIFs. This is consistent with the CFC rules. The active business test is discussed below.

Again, consistent with the CFC rules, investors that do not satisfy the active business test attribute the portion of attributable (passive) income that corresponds with their income interest in the FIF. Because a FIF is not a CFC, investors are unlikely to have the same level of control as shareholders in a CFC, and also the interest will be accounted for differently in the financial statements of the investors. Thus, the attributable FIF income method contains some features unique to the FIF rules. Specifically, some of the key modifications to the CFC rules are found in s EX 50, and are:

(i) Under the CFC rules, New Zealand investors that have more than one majority-owned CFC in a jurisdiction are allowed to use consolidated accounts (referred to as test groups in the CFC rules) for all their majority-owned CFCs in that jurisdiction for the purposes of the active business test.

The non-portfolio rules also allow the use of consolidated accounts to simplify the active business test. The equivalent consolidation rule for investors in non-portfolio FIFs is broader than its CFC counterpart. This enables investors to use consolidated accounting information (before removing amounts for minorities) for chains of FIFs, including FIFs that are resident in different jurisdictions. This is discussed more fully below.

(ii) The accounting standard requirements in s EX 21C for the active business test are made more accommodating for people with interests in non-portfolio FIFs. For non-portfolio FIFs the applicable accounting standard requirements (whether for a test group or otherwise) will be met if:

- The interest holder or other person has accounts that include the accounts of the FIF, including by proportionate consolidation under IAS31; or
- The FIFs accounts are prepared under US GAAP and meet the requirements of s EX 21C(8) (auditor requirements) and the interest holder or other person has accounts that include dividends and fair value changes in relation to the FIF under NZIAS 39, or accounts for the investment under the equity method in NZIAS 28 or NZIAS 31.
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Note in relation to the first point that allows proportionate consolidation, there is an assumption that the New Zealand interest holder will be able to access sufficient records of the FIF to identify whether the income is active or passive. In relation to the second point, while it is acceptable to use the accounts of the FIF prepared under US GAAP, this is subject to the inclusion of income from the FIF in the IFRS accounts at some level – even if only as dividends or an equity-accounted amount.

(iii) Under the existing CFC rules, in the event the active business test is not met, there is an exemption from attributable CFC amounts in s EX 20B for royalty, rent and financial arrangement income derived from associated CFCs, as long as the CFCs are in the same jurisdiction and the CFC that makes the payment is a non-attributing active CFC (ie passes the active business test).

This exemption is modified for non-portfolio FIFs to limit its application to payments between FIFs that are commonly controlled; that is when a group of persons holds more than 50 per cent of the voting interests in the FIF and the foreign company making the payment (thus the recipient foreign company must have an income interest of more than 50 per cent in the foreign company making the payment). This is designed to limit the exemption to payments between sister FIFs, or when a FIF holding company controls an active FIF. The other conditions are:

- The payer is a foreign company that the person uses the attributable income method for; and
- If the payer company were a CFC, it would be a non-attributing active CFC; and
- The FIF and the foreign company each have a “taxed FIF connection” with the same country or territory. This taxed FIF connection replaces the “same jurisdiction rule”. The definition of “taxed FIF connection” describes a company that is a resident of and liable to tax in the country or territory concerned, and is not resident or liable to tax in another country, nor does it have a permanent establishment in another country. FIFs that are wholly owned by a FIF that meets these rules, and is liable to tax on the FIFs income in the same country, will also satisfy the taxed FIF connection.

(iv) In many cases a New Zealand investor will own shares in a foreign company which itself owns shares in a second foreign company. The scheme of the CFC and (the soon to be repealed) branch-equivalent FIF rules (BE FIF) has always been that when a CFC or BE FIF owns a FIF, any FIF income is not included in the attributable CFC income or BE FIF income, but rather the person with the interest in the CFC or BE FIF has an additional amount of FIF income taxed directly to the New Zealand investor.

Under the new rules for non-portfolio FIFs, if the investor is using the attributable FIF income method in respect of the first foreign company, they will be required to “look-through” and to apply a FIF calculation method with respect to their indirect interest in the second foreign company. This is consistent with the prior BE FIF method.

However, the new non-portfolio FIF rules contain exceptions to the “look-through” rule in s EX 50(6). The purpose of the exceptions is to enable investors to apply the active business test using consolidated accounting information in situations when they have a direct interest in a FIF that holds shares in other foreign companies, thus, overcoming the need to look through.

Thus, under the new attributable FIF income method, where a FIF has an interest in another FIF, the person does not have additional FIF income if:

- The second foreign company is able to apply and pass the active business test on its own terms, independent of the first tier FIF – but note an indirect interest of 10 per cent in the second foreign company is required to use the attributable foreign method; or
- The FIF and the second foreign company meet the test for a non-attributing active CFC under s EX 21B(2) as part of a test group; or
- The second foreign company would meet the test for a non-attributing active CFC under s EX 21B(2) if the following amounts were included in the items “added passive” and “reported revenue” in s EX 21E:
  - Amounts recognised in the profit and loss under the equity method, as per NZIAS 28, NZIAS 31 or an equivalent IFRS standard or US GAAP standard;
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- Amounts recognised in profit or loss under proportionate consolidation under NZIAS 31, an equivalent IFRS standard or US GAAP standard;
- Dividends and fair value changes recognised in profit and loss for investments accounted for under whichever is appropriate of NZIAS 39, an equivalent IFRS standard or US GAAP standard; or
- The interest in the foreign company would be exempt under the Australian resident company exemption in s EX 35 if held by the person.

This is discussed in more detail below.

**Active business test [ss EX 21D, EX 21E and EX 50]**

The active business test is passed and no income is attributed if less than five per cent of the gross income of the non-portfolio FIF is passive. If the test is failed, then only the passive income (such as interest, rent or royalties) is attributed to the New Zealand shareholder.

Under the CFC rules [ss EX 21D and EX 21E], for the purposes of the active business test, New Zealand investors that have an interest in more than one majority-owned CFC in the same jurisdiction are allowed to use consolidated accounts (test groups) for all their majority-owned CFCs in that jurisdiction.

The non-portfolio FIF rules are based on the CFC consolidation rule, but with three notable differences (contained in s EX 50(4B)) designed to make the active business test more accessible:

- The CFC rules require the investor to have a more than 50 per cent income interest in each CFC. Under the attributable FIF income method it is the FIF in respect of which that method is used that must have a more than 50 per cent voting interest in the lower-tier foreign companies. Voting interests include interests that are held directly or indirectly.
- The CFC rules require all relevant CFCs to be subject to the laws of the same jurisdiction in order to apply the active business test on a consolidated basis. Under the attributable FIF income method, the foreign companies can be in different jurisdictions (as long as none of those companies is a CFC).
- Finally, the CFC rules require the investor to remove amounts corresponding to minority interests. The attributable FIF income method omits this requirement so amounts belonging to other investors are included in the calculations. This is because of concerns about the practical difficulties for a non-controlling shareholder identifying amounts attributable to other shareholders.

**Applying the FIF calculation methods to lower-tier foreign companies – look through rule [ss EX 50(6), EX 50(7) and EX 50(7B)]**

As above, the new rules modify the approach to looking through a first-tier FIF to its underlying FIFs when the new attributable FIF income method is used.

When a person with an interest in a FIF has itself an interest in an underlying FIF (the second FIF), the person will not have additional FIF income under the look through rules when:

- The second foreign company meets the test for a non-attributing active CFC under s EX 21B(2) (that is, it meets the active business test in its own right), and the person would be able to use the attributable FIF income method if the person held the FIF interest directly. In this regard note that under new s EX 46(3) the person’s indirect interest in the second foreign company would have to exceed 10 per cent for the person to be entitled to use the attributable FIF income method [see s EX 50(7B)(a)(i)]; or
- The FIF and the second foreign company are able to apply and pass the active business test as part of the same test group. To be part of the same test group the FIF must hold a 50 per cent or greater voting interest in the second foreign company, and the second foreign company must not be a CFC [see s EX 50(7B)(a)(ii)]; or
- The FIF is able to apply and pass the accounting-based active business test in s EX 21E (as modified by s EX 50(4B)(cb), (cc), (cd) and (ce)) even after some relevant amounts from the second foreign company are included in the “added passive” item as per s EX 50(7B)(b).
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Note in relation to the third point, the commentary to the Bill noted “the relevant amounts will differ depending on the level of shareholding that the FIF has in the second foreign company. If the FIF holds a joint venture interest in the foreign company the amounts which would be recorded in that FIF’s accounts under New Zealand Equivalent to International Accounting Standard 31 (NZIAS 31) would need to be included. If the FIF holds 20 per cent or more, but less than 50 per cent of the foreign company, then amounts recorded under the equity method in that FIF’s accounts under NZIAS 28 would need to be included. If the FIF holds less than 20 per cent of the foreign company then any dividends and holding gains recorded under NZIAS 39 for that company would need to be included.” Note: it is understood that the intention is that including the point three amounts in the “added passive” item is optional. This is not clear from the legislation and may need amending.

An example based on the commentary to the Bill illustrates how this may work:
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If the New Zealand investor chooses to apply the attributable FIF income method to FIF 1 (recall the FDR method can now be used for non-portfolio FIFs which only looks at direct interests so does not look through), it can apply the test for a non-attributing CFC under s EX 21B(2) as per normal to determine if FIF 1 passes the active business test. That is, it can apply the active business test based on the accounts of FIF 1, or it could use the consolidated (test) group accounts.

Consolidation is based on whether FIF 1 has a voting interest of more than 50 per cent in the other companies [s EX 50(4B)(b)]. Also, consolidation is not limited to subsidiary companies in the same jurisdiction [s EX 21E(2)(b)] does not apply as written for FIFs, see s EX 50(4B)(g)]. This being the case, line items in FIF 1’s accounts will consolidate amounts from FIF 2 and FIF 3. These amounts will be included in the “reported passive” item for the purposes of the test in s EX 21E.

FIF 4 is unable to be consolidated as such. However, it will not be necessary to look through to FIF 4 if, by applying s EX 50(7B)(b) FIF 1 would still meet the active business test. That is, if by including amounts from FIF 4 under the appropriate accounting standard (for example as income from equity in associates), in “reported passive” and “reported revenue” for the test group the active business test is met, then look through is not necessary. If the test was not met, it would be necessary to look through to FIF 4.

Changes to FIF income calculation methods

Changes have been made to the existing FIF income calculation methods to remove the accounting profits and branch equivalent methods and accommodate the introduction of the new attributable FIF income method. These changes are summarised below. As with the changes to the non-portfolio rules these apply for income years beginning on or after 1 July 2011.

Attributable FIF income method (and repeal of the branch equivalent method)

Section EX 46(3) previously allowed the use of the branch equivalent method. This has been replaced by the new attributable FIF income method. Section EX 46(3) only permits the use of the attributable FIF income method if the person can provide to the CIR, if requested, sufficient information to enable the CIR to check the calculations required by s EX 50, and at all times in the FIF’s accounting period:

- The FIF is a company; and
- The income interest of the person in the FIF, as defined in s EX 50(4), is 10 per cent or more; and
- The person is not a PIE.

If use of the attributable FIF income method is not available the other methods available are the FDR method or its sister method, the cost method. The Comparative value method is also available but this is limited to natural persons and trustees of family trusts. Thus, PIEs must use FDR or the cost method if the attributable FIF income method is not used.

The income interest of the person as set out in s EX 50(4) refers to the provisions that define an income interest in a CFC, and includes indirect interests. In the FIF rules, the general rule is that a FIF interest is a direct interest. That is, generally FIFs are not looked through. However, when the attributed FIF income method is used, like its branch equivalent method predecessor, the look through rule in s EX 50(6) applies. Generally, for these purposes, the New Zealand resident must have an indirect income interest of 10 per cent or more in the FIF that is being looked through to. However, look through may not be necessary if the active business test is passed in relation to underlying FIFs and this test needs to be considered first. In determining if a person has an indirect interest of 10 per cent or more, the interests of associated persons are not taken into account [s EX 50(4)].

An exception to the requirement to have an income interest of 10 per cent or more is made for a limited number of shareholders who were understood to be using the branch equivalent method to calculate income from a foreign company that is also a CFC when their interest was not 10 per cent or more, as required by s EX 14. By repealing the branch equivalent method the most likely FIF income method available would be the cost method (i.e. FDR may not be available as no market value is available except by independent valuation – see s EX 46(9)(b)). This is considered a harsh outcome if, under the branch equivalent method, the tax liability was lower than a deemed return of five per cent. Thus, s EX 46(3)(b) allows shareholders with
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interests of less than 10 per cent in a FIF that is also a CFC to use the attributed FIF income method provided the market value of the interest is not available, otherwise than by independent valuation. The shareholder cannot be a listed company, group investment fund, PIE, superannuation scheme, unit trust or a trustee of a trust with a beneficiary who is one of the aforementioned entity types. Further, s EX 46(3)(b) does not apply if the CFC has any other shareholder with an interest of 10 per cent or more that is one of those entity types.

Fair dividend rate (FDR) and cost methods

The FDR and cost methods are no longer limited to portfolio FIF interests of less than 10 per cent. This is achieved by removing ss EX 46(7) and EX 46(9)(a). Thus, there is nothing to prohibit a person using the FDR or cost method for non-portfolio FIF interests if this would give a better result. Of course the consistency rules in s EX 62 will need to be considered. These allow a change to or from the attributable FIF income method without the need to give a reason for the first change, but subsequent changes to or from the attributing FIF income method must be due to a change of circumstances that changes the ability to obtain information to comply with the attributable FIF income method, and altering their income tax liability is not the principal purpose or effect of the change [s EX 62(6) and (7)].

If a person does not choose a FIF calculation method (and is not required to use a certain method), they are deemed to have chosen to use the FDR method, or the cost method if it is not practical to use the FDR method. This is achieved by changes to the default calculation methods in s EX 48. This provision would apply when a person has not complied with their FIF obligations and the CIR is seeking to NOPA or raise an assessment.

Proposed repeal of accounting profits method

The accounting profits method is repealed with application from an investor’s first income year beginning on or after 1 July 2011. This means the accounting profits method can still be used for the 2010-11 income year, and the 2011-12 income years if this started prior to 1 July 2011. Persons who used the accounting profits method in the year immediately preceding the repeal of this method are able to change to any other method (see new s EX 62(10)), subject to the limits on the choice of method in s EX 46.

Comparative value (CV) method

Investors are able to choose the CV method if:

• They are a natural person or a trustee of a family trust and do not use the fair dividend rate or cost method for any of their other interests; or
• The interest is a non-ordinary share under s EX 46(10).

This reflects the existing limitations on choosing the CV method under the portfolio FIF rules. Section EX 46(6)(c), which prevented the above limitations from applying to FIF interests of 10 per cent or more, has been repealed. Thus natural persons and trustees of family trusts can use CV for both portfolio and non-portfolio interests. Companies and other entity types are not able to use CV at all.

When a person chooses to use the CV method for one FIF interest they are not able to use the FDR method or cost method for their other FIF interests for which the FDR method could be used. This result is achieved by s EX 46(8)(b). This is the existing rule.

Note although the legislations says that CV “may be used” if an investor has a “non-ordinary share” (share that is equivalent to debt) as defined in s EX 46(10), CV is the only FIF method available if it is practical to get an end of year market value for that share [s EX 46(6)(d)]. If a market value is not available deemed rate of return is required to be used.

Note also that FIF losses under the CV method are now reduced to nil for all CV FIF losses other than when the CV method is essentially compulsory for non-ordinary shares. Other losses using the CV method are limited to zero. This applies for both portfolio and non-portfolio FIF interests. Previously non-portfolio losses calculated under the CV method were deductible in full. The repeal of s EX 51(7)(a) achieves this result.
Deemed rate of return method

Investors will only use the deemed rate of return method when they have a non-ordinary share and it is not practical to get an end of year market value for that share to undertake the CV method. This is achieved through the repeal of s EX 46(4) and amendments to s EX 46(5).

Previously, the deemed rate of return method was available for non-portfolio interests. However, with the ability to use FDR and cost methods (which apply tax to an assumed five per cent return) for portfolio and non-portfolio investments, it is no longer necessary to retain the deemed rate of return method as this deems a higher return (circa nine per cent) than the five per cent deemed income under FDR and the cost methods. Thus, the deemed rate of return method is now just a back up method to CV when a market value is unavailable as per s EX 47.

Other changes to the FIF rules

Opting out of the $50,000 De Minimis rule

Amendments have been made to the $50,000 de minimis rule in s CQ 5(1)(d) and (e) and s DN 6(1)(d) and (e) to allow taxpayers to disregard the de minimis threshold, below which the FIF rules do not apply. This allows persons that have not exceeded the threshold to apply the FIF rules if that gives a better tax outcome. This can often be the case with foreign superannuation for example. To prevent taxpayers opting in and out of the $50,000 de minimis threshold, taxpayers that have returned FIF income from FIF interests that cost $50,000 or less in any of the preceding four income years must continue to do so. To get the benefit of the $50,000 de minimis threshold again taxpayers would have to cease to hold attributing FIF interests that cost $50,000 or less for four complete tax years.

Inherited FIF interests

Shares in former grey list companies that were inherited prior to 1 April 2007 have, until now, been regarded as having a cost of nil. This has meant that, unless the person that inherited the share had other FIF interests exceeding $50,000, no FIF income was calculated on these foreign shares. This was discussed in the Institute of Chartered Accountant’s Journal, vol 88, Issue 5, June 2009 at 26 and 27.

However, from the date of enactment of the Taxation (International Investment and Remedial matters) Act (which at the time of printing is awaiting enactment) persons holding inherited FIF shares are deemed to dispose of the shares and reacquire them for an amount equal to their market value at that time. If this value exceeds $50,000 the person will then be treated as though the cost of their FIF interests exceeded that threshold at that time. This will mean for most that dividends will from that time forward be subsumed into the FIF income calculation rules, and from the start of the next income year, the person will have to calculate income under the FDR method.

For those people who hold these shares on capital account, no income tax liability will arise on the deemed disposal and reacquisition. However, in the rare case when the shares were held on revenue account, for the purposes of determining any taxable gain on the deemed disposal:

• The cost of the shares is deemed to equal the lesser of the market values at the time of inheritance and the time of deemed disposal; and
• The tax liability is spread forward over three income years under s EX 67B(3); and
• No liability for penalties and interests arises on these amounts.

Zero rate of AIL on bonds

The amendments to lower the rate of AIL on certain bonds issued in New Zealand to zero per cent is designed to lower the tax barrier to non-resident investment in New Zealand corporate bonds. Also, if the incidence of this tax falls on the New Zealand borrower this impacts on the cost of capital in New Zealand more broadly.

The changes apply a zero per cent rate of AIL on certain qualifying bonds, essentially widely-held and issued in New Zealand. The change will apply to interest payments made on or after the date the bill is enacted, which will allow the zero rate to be used in respect of future interest payable on bonds issued before enactment.
The key requirements for a qualifying bond are:

The security must first comply with the usual AIL registration requirements in s 32M of the TAA and s 86H of the Stamp and Cheque Duties Act 1971. That is, it must have been eligible to apply AIL of two per cent to the security and:

- The security is denominated in New Zealand dollars; and
- The security is offered to the public for the purposes of the Securities Act 1978; and
- The security is not issued as a private placement; and
- The security is not an asset backed security; and
- The registry and paying agent activities for the security are conducted through a fixed establishment in New Zealand; and
- The security is listed on an exchange registered under the Securities Markets Act 1988 (NZDX) or the widely-held test is met.

These requirements are explained in a little more detail below.

Normal registration required

To access the zero rate of AIL the issuer of the security must be an approved issuer under s 32M of the TAA and must have registered the security under s 86H of the Stamp and Cheque Duties Act 1971. This allows AIL to be paid at two per cent.

Section 86I of the Stamp and Cheque Duties Act 1971 is amended so that AIL is considered to be paid when either the existing two per cent rate is paid, or the new nil rate applies. When AIL is considered to be paid, a nil rate of non-resident withholding tax will apply under s RF 12 so long as the borrower and lender are not associated and so long as the interest is not jointly derived with a New Zealand resident. Regardless of whether they pay AIL at two per cent or zero per cent, approved issuers will need to continue to file an AIL return/payment slip by the 20th day of the month following the month in which the interest payment was made. This slip will now require the approved issuer to record the total amount of interest payments that have been zero-rated. A person will not generally be able to get the zero rate of AIL in respect of any interest payments in which they fail to provide this information by the 20th day of the following month. However, there is scope in s 86I(2)(b)(ii) of the Stamp and Cheque Duties Act 1971 for the CIR to provide a later deadline in a notice given to the approved issuer. Alternatively an approved issuer that is late at supplying this information would still be able to get a two per cent rate of AIL under s 86I(2)(a) if they pay AIL at a later date along with interest and penalties.

Issued publicly in New Zealand

The security must be denominated in NZD and issued under an offer to the public for the purposes of the Securities Act 1978 and are not a private placement [Stamp and Cheque Duties Act 1971, s 86IB(1)].

In terms of being offered to the public, the securities must be an offer to the public in compliance with the Securities Act 1978. The Securities Act does not define an offer of securities to the public, but s 3 of the Act lists people who are not considered to be members of the public. These include associates, institutional investors, underwriters and investors who pay a minimum subscription price of at least $500,000 before allotment of the securities. The Securities Act requires the preparation of an investment statement, a registered trust deed and (generally) a registered prospectus before a debt security can be issued to the public.

Private placements are excluded. A “private placement” is not a formally defined term in the Income Tax Act so this exclusion relies on the ordinary meaning of the term. For example, securities that were exclusively issued to a group that were pre-selected by the issuer would probably be considered to be a private placement.

Not an asset-backed security

Again, an “asset-backed security” is not formally defined so would be interpreted using the ordinary meaning of this term. For example, securities with interest payments directly financed out of cash-flows from a pool of financial assets, such as mortgages or other loans, could be considered to be asset-backed securities. Inland
Revenue’s explanation of the purpose of this requirement is to deny the zero rate of AIL in cases where a group of loans have been bundled together and securitised into a bond. The concern is that such securities could be used to shift the margin earned on closely-held loans (such as mortgages) outside the New Zealand tax base. Note that this measure is not intended to exclude bonds that are simply secured against a collateral asset that the bond holder can claim in the case of default.

**Listed on the NZDX or widely held**

The securities must either be listed on an exchange registered under the Securities Market Act 1988, or alternatively pass a widely-held test.

Currently, the NZDX is the only debt exchange that is registered under the Securities Markets Act 1988. Securities listed on the NZDX will not need to apply the widely-held test and are expected to generally satisfy the other requirements listed above.

The widely-held test is outlined in new s 86IB(2). A bond needs to satisfy the widely-held test at or before the time of the interest payment. This means that if the test has been satisfied on one previous occasion it is not necessary to re-apply the test a second time.

There are four limbs to the widely-held test that must all be satisfied:

- The bond is one of a number of identical debt securities that are registered securities; and
- The securities must be held by at least 100 separate persons; and
- The issuer has reasonable grounds for expecting that each of the 100 or more bond holders is not associated with the issuer, or associated with another bond holder; and
- That no person or group of associated persons holds more than 10 per cent of the value of the securities at the time the test is applied.

Note: the securities need not all be issued on the same date so long as the debt securities are identical. For example if half the bonds were issued in January and half in August and by 14 September the total number of bondholders has reached 100 persons, then the test could be satisfied in respect of interest payments made on or after 14 September. This means that issuers can build up to 100 investors over time, although they will only get the nil rate of AIL in respect of interest payments made on or after the first day that the securities satisfy the widely-held test.

If the number of bond holders subsequently drops below 100, the test will still be satisfied so long as this threshold was not met simply because of an arrangement (that the issuer could reasonably be expected to be aware of) that was intended to temporarily increase the number of persons holding the bonds [s 86IB(2)(c)(ii)].

**Other Changes**

**PIEs with non-portfolio interests in CFCs or FIFs**

For income years beginning on or after 1 July 2011, proposed amendments will treat all CFC interests held by a portfolio investment entity (PIE) as if they were not CFC interests. This does not mean that the foreign company would stop being a CFC; it means the PIE will use the FIF rules as opposed to the CFC rules. A similar amendment will prevent PIEs from accessing the foreign dividend exemption (currently only multi-rate PIEs are excluded from this exemption). PIEs will not actually be taxed on foreign dividends, because they will be treated as only having FIF income from their FIFs.

**Branch equivalent tax accounts (BETAs) of companies and conduit tax relief accounts (CTRAs)**

**Repeal of BETAs of companies and CTRAs**

Following changes in the Taxation (International Taxation, Life Insurance and Remedial Matters) Act 2009, all credits in BETAs of companies were cancelled. However, the BETA was retained for a period of two years, to allow the use of BETA debit balances to prevent the double taxation of attributed foreign income.
**Future Developments**

To complete the repeal of BETAs for companies, BETAs with debit balances and related rules are to be repealed from the beginning of the fourth income year that the taxpayer is required to comply with the new international tax rules (ie the first income year beginning on or after 1 July 2012).

CTRAs and related rules are to be repealed from the beginning of the first income year beginning on or after 1 July 2011. Dividends not paid before this date will not be able to have conduit tax credits attached to them.

Elections to use BETA debit balances to relieve tax on attributed foreign income will only be available for tax on attributed foreign income that is allocated to the second year, under the international tax rules, or to an earlier year. This would apply from the first income year beginning on or after 1 July 2009.

Note: Although the BETA rules were retained for three income years after the introduction of the new international tax rules in 2009, the ability to use BETA debit balances remains for the third year only, to allow determination of the income tax position and filing of returns for the second year. Because BETAs balance to the imputation year of 31 March, there may be some taxpayers for whom the final year (eg for a 31 December balance date company, the BETA will not be available from 1 January 2013) falls in an imputation year. In this case, the BETA will have to be kept for the imputation year ending 31 March 2013.

**Remedial amendments: BETAs of companies**

Minor changes are to be made to the ITA to ensure that BETAs cannot go into credit. These changes apply to income years beginning on or after 1 July 2009.

**Changes to the thin capitalisation rules**

**Applying the thin capitalisation rules to active FIFs**

The thin capitalisation rules are to be amended so that investors using the attributable FIF income method, or the exemption for FIFs resident in Australia, are subject to the same thin capitalisation rules that currently apply to investors in CFCs.

The amendments to outbound thin capitalisation rules would apply to New Zealand residents with CFCs or FIFs for which they use the attributable FIF income method, or New Zealand residents that use the s EX 35 exemption for FIFs resident in Australia. Assets from these entities will be included in the worldwide group assets, but not in the New Zealand group’s assets, for the purposes of determining if the New Zealand group’s debt to asset ratio is below 110 per cent of the worldwide ratio. The proposed changes would apply to income years beginning on or after 1 July 2011.

**New thin capitalisation test for low-asset companies**

A new thin capitalisation test is proposed for certain New Zealand-based groups with offshore investments. This will give certain New Zealand taxpayers an alternative test to comply with the thin capitalisation rules. Where New Zealand multinational groups have a high level of arm’s length debt, and if certain other conditions are met, they can choose that the test for thin capitalisation be based on a ratio of interest expenses to pre-tax cash flows, rather than on a debt-to-asset ratio.

The proposed changes apply for income years beginning on or after 1 July 2009, and will apply retrospectively so that companies that experienced difficulties immediately after the extension of the thin capitalisation rules will be able to obtain relief.

**State-owned banking groups**

The thin capitalisation rules are to be altered to permit the Kiwibank group of companies to be treated separately from the rest of the New Zealand Post group. The reason for this is to reduce compliance costs, and to ensure that the appropriate thin capitalisation test is used for the non-banking part of the New Zealand Post group. This amendment would apply retrospectively for income years beginning on or after 1 July 2009.

**Application to non-residents with no fixed establishment**

The thin capitalisation rules are to be amended to limit their application in the case of non-resident companies that do not carry on business through a fixed establishment in New Zealand. Such companies will no longer
be subject to the rules if all their New Zealand-sourced income that is not relieved under a double tax agreement is non-resident passive income. This will apply to income years beginning on or after 1 July 2011.

**Exemption from the outbound rules**

A provision [s FE 5(1B)(b)] which exempts excess debt outbound companies from the thin capitalisation rules if total interest deductions for the New Zealand group do not exceed $250,000 is to be repealed. This exemption is rendered effectively redundant by another provision, which reduces to zero the deductions subject to apportionment under the thin capitalisation rules where the finance costs of an outbound entity do not exceed $1 million. This will apply to income years beginning on or after 1 July 2011.

**Miscellaneous remedial changes**

**Qualifying companies amendment**

It is proposed that qualifying companies be excluded from having any income interests in a CFC, or interests of 10 per cent or more in an FIF. Currently, the legislation refers to “attributing interests”, which has unintended consequences. The change would apply to income years beginning on or after 1 July 2009.

**Amendment to non-resident exclusion from conduit anti-avoidance rule**

The conduit anti-avoidance rule in s GZ 2 is to be amended to exclude conduit tax relief received by a CTR-group member to the extent that the CTR-group member is owned by non-residents. The change would apply to income years beginning on or after 1 July 2009.

**Attributed foreign income**

For income years beginning on or after 1 July 2009, the scope of income that can be excluded from attributed foreign income is to be expanded by permitting some companies, which are not recognised for tax purposes in the country they operate in, to nevertheless be treated as resident in that country. This amendment is retrospective so that affected taxpayers can benefit from the policy from the inception of the international tax rules.

**Insurance CFC determination**

The CIR is currently able to issue a determination that an insurer is a non-attributing active CFC. The authorising provision is to be amended, for income years beginning on or after 1 July 2009, to expressly give the CIR the ability to stipulate conditions that must be satisfied in addition to the existing requirements for a CFC or CFC group member to qualify as a non-attributing active CFC.

**Foreign dividend exemption — deductible dividends**

Under existing law, deductible foreign equity distributions are specifically excluded from the foreign dividend exemption in s CW 9. A proposed amendment, to apply from the date of introduction of the Bill, widens the definition of “deductible foreign equity distribution” to include payments received by a company that give rise to a deduction for foreign tax of any person, whether a company or not. Previously, the definition was limited to amounts that were deductible to the company making the distribution, and to companies in the same group of companies as the distributing company.

**Losses of CFCs**

The transitional provisions dealing with CFC losses arising under the old international tax rules, and being carried forward under the new international tax rules, are to be reworded to ensure that the transitional rule applies to all ring-fenced losses, as intended. This applies for income years beginning on or after 1 July 2009.

**Foreign tax credits of CFCs**

The transitional provisions dealing with foreign tax credits arising under the old international tax rules, and being carried forward under the new international tax rules, are to be reworded to make it clear that the transitional rule applies to all carried-forward credits, as intended. This applies for income years beginning on or after 1 July 2009.
Future Developments

**Taxation (Income-sharing Tax Credit) Bill**

At the time of publication, the Finance and Expenditure Committee had reported back to Parliament on the Taxation (Income-sharing Tax Credit) Bill and recommended that it proceed. The Bill was introduced on 16 August 2010 and proposes to provide an annual tax credit to resident couples who are married, or are partners in a de facto relationship or a civil union, and who have responsibility for a dependent child aged up to 18 years. The effect of the credit would be to assess such couples for income tax as if they each received half of the total household income. The cost of the credit is estimated to be $500 million annually.

**Taxation (Annual Rates, Returns Filing and Remedial Matters) Bill**

**Return filing requirements**

Proposals include:

- Taxpayers who choose to file a return when not required by law to do so will be required to also file a return for each of the four years prior to the year that they wish to file.
- The requirement that taxpayers file a return of income merely because they are in receipt of Working for Families is to be abolished.
- The two most common returns, being the IR 3 return for individuals and the Personal Tax Summary, are to be amalgamated.
- The Commissioner of Inland Revenue is to be able to authorise data storage providers to store clients’ tax records offshore. Any such authorisation will be able to be revoked.
- Taxpayers who file returns electronically are to be able to store them electronically rather than being required to retain a paper copy.

**Profit distribution plans**

Under a profit distribution plan, a company issues bonus shares to its shareholders. The shareholders are able to elect to have the company repurchase the bonus issue shares immediately following their receipt by the shareholder. The bonus issue is treated as a non-taxable bonus issue. If the shares are repurchased, the cash amount received is treated as a taxable dividend and imputation credits are able to be attached. The Bill proposes to make the bonus issue taxable. One of the reasons for the reform is to prevent the possibility of PDPs being used as an imputation credit streaming mechanism.

**Tax treatment of unsuccessful software developments**

The proposal is to allow an immediate deduction for expenditure incurred on unsuccessful software development projects. The deduction will be allowed in the year in which the development is abandoned.

**GST**

An amendment is to be made clarifying that late payment fees charged by a business to a customer are subject to GST. Interest charged on overdue amounts will continue to be GST-exempt. The application date of the change to be 1 April 2003 with a savings provision to preserve the past GST treatment where a person has adopted a practice of treating late payment fees as exempt supplies. In these cases, the application date is to be 1 April 2012.

Liquidators, receivers and voluntary administrators are to be prohibited from changing a registered person’s GST accounting basis from the payments basis to the invoice basis.

**Banking industry**

The minimum equity threshold of a reporting bank’s New Zealand banking group is to be increased from four per cent to six per cent of risk-weighted exposures.

**Income tax rates**

Income tax rates for the 2012–13 income year are to remain the same as for the 2011–12 income year.
Chapter 20

Accident Compensation

20.10 Purpose and recent history

The purpose of the Accident Compensation Corporation (ACC) scheme is to provide a universal, no-fault system of health care, rehabilitation and compensation for all personal injuries caused by accidents. In broad terms, the scheme pays for the medical and rehabilitation costs of personal injuries caused by accident. The scheme also provides compensation, where applicable, for income lost during the period of incapacity. Due to the schemes existence, apart from exemplary damages, there is no right to sue for accidents incurred in New Zealand.

The ACC scheme is funded by levies imposed upon employers, employees, self-employed persons, and motorists. Accident compensation levies are compulsory. The levies apply for a levy year that runs from 1 April to 31 March. In March 2000, following a brief period when accident compensation was available from various insurance companies, legislation was enacted so that the statutory scheme became reinstated as the only supplier of accident compensation cover to employers.
20.15 Types of ACC levies payable

The levies are set each for each levy year, and are effectively made up of two parts, to cover:

(a) Claims for work and non-work accidents for the year ahead (which also includes funds to cover the lifetime cost of injuries that will occur); and

(b) Residual claims levy, which in general terms is for claims relating to injuries prior to 1 July 1999.

Both employees and self-employed pay levies into the work account, (for work-related accidents), and the earners account (for injury outside the work place). For employees, the work account levy (referred to as WorkPlace Cover) is paid by the employer [see 20.55] and the earner’s levies are deducted from their salary and wages through the PAYE system. For self-employed, the work and earners account levies are paid by the self-employed person through either the ACC CoverPlus or CoverPlus Extra products [see 20.40 and 20.45].

The residual claims levy is payable by both employers and self-employed. The residual claims levy is payable in respect of both the work account and earner’s account. The levy is designed to meet the on-going costs of work injuries that happened before 1 July 1999, and non-work injuries that happened before 1 July 1992. There is also an earners residual claims levy which meets the costs of non-work-related injuries to earners between 1 July 1992 and 30 June 1999 (although this levy has not been charged for the 2008-2009 levy year and the previous two years). As with the work and earners accounts, employers pay or deduct the residual levies on behalf of employees. For self-employed people on CoverPlus or CoverPlus Extra it is invoiced directly, but residual levies for non-PAYE shareholder-employees on CoverPlus Extra are invoiced to the employer.

The various levy rates for the work account depend on the different industry classifications and are set out in yearly ACC publications [ie Agent’s Guide — Your Guide to Business Industry Descriptions, Codes and ACC Levies]. Levies payable by employees are based on earnings and are collected through the PAYE system, while levies payable by employers and self-employed persons are invoiced direct from the ACC.

Levies are also paid by Government into a non-earners account for people not in paid employment. A motor vehicle levy is paid through the annual vehicle registration fee and incorporated in the price of petrol for injuries to people using public roads.

Summary of ACC accounts:

<table>
<thead>
<tr>
<th>Account name</th>
<th>Levy paid by</th>
<th>What the account pays for</th>
</tr>
</thead>
<tbody>
<tr>
<td>Work account</td>
<td>All employers and self-employed.</td>
<td>Work-related personal injuries to employees, self-employed people, shareholder-employees and private domestic workers. This does not include work injuries that happened before 1 July 1999; these are funded by the residual claims account.</td>
</tr>
<tr>
<td>Earners account</td>
<td>Everyone in the paid workforce. Employees pay through their PAYE and self-employed people are sent an invoice.</td>
<td>All injuries to people in paid employment that happen outside of work (eg on the sports field or at home). This does not include motor vehicle accidents.</td>
</tr>
<tr>
<td>Non-earners account</td>
<td>Direct payment from Government from general taxation.</td>
<td>Injuries to people who are not in the paid workforce, such as students, visitors from abroad, beneficiaries, retired people and children. This does not include motor vehicle accidents.</td>
</tr>
</tbody>
</table>
### Account name

<table>
<thead>
<tr>
<th>Account name</th>
<th>Levy paid by</th>
<th>What the account pays for</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor vehicle account</td>
<td>A levy on the price of petrol and from a component of the motor vehicle licensing fee.</td>
<td>Injuries to people involving motor vehicle accidents on public roads.</td>
</tr>
<tr>
<td>Treatment injury account</td>
<td>The earners, and non-earners, accounts.</td>
<td>Personal injuries that are caused by medical treatment. Before 1 July 2005, these injuries were called “medical misadventure”.</td>
</tr>
<tr>
<td>Residual claims account</td>
<td>Levies are paid by employers, self-employed people and shareholder-employees.</td>
<td>Work injuries that happened before 1 July 1999, and non-work injuries prior to 1 July 1992. Up until those times levies were only collected to meet the initial costs of injuries, and not the ongoing costs such as lifetime rehabilitation. The residual claims levy is: (a) Risk-rated using the same industry classifications; (b) Has the same income tax and GST provisions applicable; and (c) Is calculated using similar maximum and minimum thresholds of income.</td>
</tr>
</tbody>
</table>

#### 20.20 Collection of ACC levies for workers and earners accounts

The following table sets out in summary form whether the levy is collected by ACC or Inland Revenue (as agent for ACC).

<table>
<thead>
<tr>
<th>Levy payer</th>
<th>Work account paid to</th>
<th>Earners account paid to</th>
<th>Residual claims levy paid to</th>
<th>Earners residual levy paid to</th>
<th>Source of data</th>
<th>How collected</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employer. For employee work place injuries.</td>
<td>ACC</td>
<td>ACC</td>
<td>ACC</td>
<td>Employer monthly schedule, IR348.</td>
<td>Billed by ACC.</td>
<td></td>
</tr>
<tr>
<td>Employee. For non-work injuries.</td>
<td>Inland Revenue</td>
<td>Inland Revenue</td>
<td></td>
<td></td>
<td>Deducted by employer along with PAYE and paid to Inland Revenue as agent for ACC.</td>
<td></td>
</tr>
<tr>
<td>Self-employed.</td>
<td>ACC</td>
<td>ACC</td>
<td>ACC</td>
<td>ACC</td>
<td>IR3</td>
<td>Billed by ACC.</td>
</tr>
<tr>
<td>Shareholder-employees (without PAYE deductions).</td>
<td>ACC</td>
<td>ACC</td>
<td>ACC</td>
<td>ACC</td>
<td>IR4</td>
<td>Billed by ACC.</td>
</tr>
<tr>
<td>Private domestic workers.</td>
<td>ACC</td>
<td>Inland Revenue</td>
<td>ACC</td>
<td>Inland Revenue</td>
<td>Employer monthly schedule.</td>
<td>Billed by ACC in respect of</td>
</tr>
</tbody>
</table>

Staples Tax Guide 2012
(1) Earner’s levy rates

Employees pay the earner’s levy to ACC to cover non-work injuries. The earner’s levy must be paid by employees, persons receiving schedular payments, and self-employed persons. The earner’s levy is imposed at the following flat rate for all liable earnings [see 20.25]:

<table>
<thead>
<tr>
<th>Earnings period</th>
<th>Rate per $100 of liable earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 April 2003 – 31 March 2004</td>
<td>$1.20 (including GST)</td>
</tr>
<tr>
<td>1 April 2004 – 31 March 2005</td>
<td>$1.20 (including GST)</td>
</tr>
<tr>
<td>1 April 2005 – 31 March 2006</td>
<td>$1.20 (including GST)</td>
</tr>
<tr>
<td>1 April 2006 – 31 March 2007</td>
<td>$1.30 (including GST)</td>
</tr>
<tr>
<td>1 April 2007 – 31 March 2008</td>
<td>$1.30 (including GST)</td>
</tr>
<tr>
<td>1 April 2008 – 31 March 2009</td>
<td>$1.40 (including GST)</td>
</tr>
<tr>
<td>1 April 2009 – 31 March 2010</td>
<td>$1.70 (including GST)</td>
</tr>
<tr>
<td>1 April 2010 – 31 March 2011</td>
<td>$2.00 (including GST)</td>
</tr>
<tr>
<td>1 October 2010 – 31 March 2011</td>
<td>$2.04 (including GST)</td>
</tr>
<tr>
<td>1 April 2011 – 31 March 2012</td>
<td>$2.04 (including GST)</td>
</tr>
<tr>
<td>1 April 2012 – 31 March 2013</td>
<td>$1.70 (including GST)</td>
</tr>
</tbody>
</table>

For employees, the earner’s levy is deducted by the employer from salary and wages along with PAYE tax deductions and paid to Inland Revenue on the same due dates as for PAYE. The earner’s levy is built into the PAYE tables. The earner’s levy is not deducted from any employee earnings which exceed the maximum earnings [see 20.35].

20.25 Earnings liable for levies

Generally, liable earnings include:

(a) Salary and wages and other income subject to PAYE (ie a bonus or extra pay);
(b) Income from self-employment;
(c) Schedular (withholding) payments;
(d) Partnership income derived by working partners; and
(e) Salary of a shareholder-employee.

Liable earnings for self-employed must be amounts that are subject to income tax and arise as a result of an individuals “personal exertion” or levies cannot be charged [IPRCA 2001, s 14]. Personal exertion includes any physical task. For example, management, book work, and administration are sufficient for the personal exertion test to be satisfied: *Caverhill v Accident Rehabilitation and Compensation Insurance Corporation* HC Rotorua AP93/97, 2 October 1998.
The principal point is that if the earnings are dependent on the person’s physical exertion then they will be liable. Earnings derived from physical exertion by some other person, for example when a sleeping partner of a partnership receives a share of the business profits, are not liable. That is, the personal exertion earnings of another partner can not be taken into account: Amies v Accident Rehabilitation and Compensation Insurance Corporation DC 119/95, 6 October 1995. Even when the income is of a business nature, some items of income (ie depreciation recovered), may not be considered income from personal exertion: G v Accident Compensation Corporation DC Wellington 151/2006, 20 June 2006. The income must also be income in the ordinary sense of the word. For example, partnership drawings are not considered income from personal exertion: Rockx v Accident Compensation Corporation DC Napier 43/2005, 14 February 2005. However, losses brought forward from a prior year are to be deducted from personal exertion income for the purposes of assessing the amount of compensation: Robinson v Accident Compensation Corporation DC Wellington 34/2006, 8 February 2006. Thus, the cases illustrate that an analysis of the nature of the income can look further into its respective components to determine both liability and compensation entitlement.

In the case of shareholder-employees, the personal exertion test is not applied. Entitlement is based on the earnings as a shareholder-employee [IPRCA 2001, s 15]. Under s 15(3) of the IPRCA 2001, other earnings from the company (eg director’s fees and dividends) may be taken into account if ACC believes that they provide a better reflection of the remuneration: Bow v Accident Rehabilitation and Compensation Insurance Corporation [1998] NZAR 385 (DC) when dividends were taken into account as earnings as a shareholder employee.

However, a subsequent appeal from a review decision has clarified the circumstances when other earnings from a company may be taken into account by a shareholder employee. In Nicholas v Accident Compensation Corporation DC Wellington 110/2008, 29 May 2008, the claimant was a shareholder employee of a company and received a salary of $60,000 for the year ended 31 March 2003. During the year the claimant also had drawings of $126,428. ACC determined the claimant’s weekly compensation on the basis of $60,000. The claimant argued that s 15(3) allowed him to value the true worth of his services as an employee and director, and had an independent assessment of the value of his services at $109,600. In rejecting the appeal, Judge Beattie found that s 15(3) of the IPRCA 2001 only permitted a reallocation of income actually returned for tax purposes. Further, Judge Beattie found that that provision had to be read in tandem with cl 31(b) of the IPRCA 2001. Clause 31(b) requires that, in determining earnings, the income tax return furnished to the CIR is to be used, provided that the return as furnished has not been influenced by the claimant’s incapacity. Judge Beattie interpreted this latter requirement as meaning that the remuneration declared can only be adjusted under s 15(3) of the IPRCA 2001 if the income returned was in some way “loaded” because of the fact of incapacity.

Thus, while Bow v Accident Rehabilitation and Compensation Insurance Corporation allowed dividends to be reallocated as earnings, it is hard to see how this could be the case following the decision in Nicholas v Accident Compensation Corporation, unless the amounts were declared as income and the amounts had not been overstated as earnings (that is, influenced by the incapacity) related to the person’s services as a shareholder employee.

For circumstances such as those in Nicholas v Accident Compensation Corporation, the approach for ACC earnings entitlement purposes would be to use CoverPlus Extra [see 20.45].

Note: Effective from 1 April 2010 a new s CD 34B of the Income Tax Act 2007 has changed the way the returns from some co-operative companies are taxed. In short, s CD 34B allows certain dividends, in the cooperative company context, to be deductible to the company and fully assessable as normal taxable income of the recipient.

Thus, for some taxpayers, and dairy farmers in particular, their return may now be a mix of dividends and trading profit. In the case of Fonterra dividends subject to s CD 34B, ACC has confirmed that the Fonterra dividend income will be treated in the same way as the value return payment (the trading profit) was treated, namely as taxable income of the recipient. Consequently, there will be no change (other than normal annual income fluctuations up or down) in the level of liable income on which levies are calculated.
For employees, the employer pays levies to ACC for work related accidents [see 20.55], and the earners account levy is deducted through the PAYE system. However, self-employed people (which includes people in a partnership, non-PAYE shareholder-employees, and people in receipt of schedular payment income) are billed by ACC in respect of their liable earnings. The information used to prepare the bill is sourced from the IR3 tax return provided to Inland Revenue. However, in the case of non-PAYE shareholder-employees, the information is sourced from the IR4 company return of income. Inland Revenue then provide ACC with the relevant earnings, so ACC is able to calculate the invoice amount.

Care needs to be taken when completing the IR3 to ensure the income liable for ACC levies is declared correctly. There are three different types of income a self-employed person can declare to Inland Revenue that are liable for ACC levies:

(a) Schedular payments (withholding payments);
(b) Partnership income; and
(c) Self-employed income.

Liable earnings are declared on an IR3 under the following key-points:

(a) Schedular payments (withholding payments) — declared under key-point 12B;
(b) Partnership income — declared under key-point 18B; and
(c) Self-employed income — declared under key-point 22

A self-employed person can also declare expenses under key-point 26 on an IR3 tax return. This figure is then deducted from the person’s total earnings to give the liable earnings.

Earnings that do not result from personal effort are not liable for levies and similarly ACC does not provide earnings-related compensation for earnings that do not result from personal exertion. This is because the income source would not cease if the person was unable to work as a result of an accident.

Beneficiary income from a trust (including trading trusts) is considered by ACC to fall into this category and is not regarded by ACC as income from personal exertion. For persons operating through a trading trust, ACC will only regard the person as an earner if they have a contract of employment with the trustees.

Earnings not liable for levies include:

(a) Interest and dividends (although note the exception in the case of certain cooperative company dividends discussed above);
(b) Foreign investment fund income;
(c) Business drawings;
(d) Amounts that are capital and not taxable;
(e) Rental income;
(f) Depreciation recovered when no continuing source of income;
(g) Non-taxable allowances;
(h) Student allowances;
(i) Income-tested benefits;
(j) New Zealand superannuation;
(k) Veteran’s pension;
(l) Living-alone payments;
(m) Redundancy payments;
(n) Retiring allowances;
(o) Jury and witness fees;
(p) Royalties;
(q) Partnership income derived by non-working partners;
Accident Compensation

20.30 Full-time and part-time self-employed earners

The hours a self-employed person works can affect the amount of ACC they pay and also the compensation they may be entitled to. This is particularly the case with minimum earnings [see 20.35], as full-time people are subject to a minimum income for levy purposes.

It is important that they notify the ACC’s Business Service Centre if the levy payer works part-time in their business. If ACC is not aware or is uncertain of the person’s part-time status, it will assume the person is full-time. If the person is not a full-time earner they may be incorrectly billed. Thus, it is important to notify ACC of part-time status.

To calculate full-time or part-time status, the levy payer needs to take the number of hours worked and average this over a 12-month period, even if they have only worked for eight months of the year, to get the average hours worked per week.

The status of the levy payer is:

(a) **Full-time**: If they work 30 hours or more per week; or
(b) **Part-time**: if they work less than 30 hours per week.

20.35 Maximum and minimum earnings

All ACC levies have a maximum level of cover. Minimum levels of cover apply to full-time self-employed. These are set by the Act or regulations and change from year to year.

(1) **Maximum**

Self-employed persons (whether full-time or part-time) who earn over the maximum will be charged a levy based on the maximum figure for that year. If the person has an accident and is incapacitated and unable to work, they will receive weekly compensation based on up to 80 per cent of the maximum.

**Example:**

The self-employed maximum for the 2009 levy year is $99,817. If a person declared self-employed income of $120,000, because they have earned over $99,817, they would receive an invoice from ACC based on the full-time maximum figure.

For employees, like self-employed persons, no ACC levy is payable on income exceeding the maximum. The PAYE tables do not include the earners levy for those weekly, fortnightly, or monthly earnings which equate to annual earnings of more than the maximum. Further, the employer does not pay the residual claims levy or earners account residual claims levy on the earnings of any employee which exceed the maximum. However, it is worth noting if an employee changes jobs during the year, and their combined earnings exceed the maximum, ACC levies in respect of both the work and earners accounts may be overpaid. In this case ACC should be contacted. Similarly, if a person derives both salary and wages and income from self-employment that collectively exceed the maximum then ACC levies on the self-employed income should be adjusted by ACC to reflect this [see 20.70].

The maximum amount of earnings on which levies are payable are:

<table>
<thead>
<tr>
<th>Earnings period</th>
<th>Maximum earnings for employees</th>
<th>Maximum earnings for self-employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 April 2003 – 31 March 2004</td>
<td>$88,728</td>
<td>$87,185</td>
</tr>
<tr>
<td>1 April 2004 – 31 March 2005</td>
<td>$92,189</td>
<td>$88,728</td>
</tr>
<tr>
<td>1 April 2005 – 31 March 2006</td>
<td>$94,226</td>
<td>$92,189</td>
</tr>
<tr>
<td>1 April 2006 – 31 March 2007</td>
<td>$96,619</td>
<td>$94,226</td>
</tr>
</tbody>
</table>
Accident Compensation

<table>
<thead>
<tr>
<th>Earnings period</th>
<th>Maximum earnings for employees</th>
<th>Maximum earnings for self-employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 April 2007 – 31 March 2008</td>
<td>$99,817</td>
<td>$96,619</td>
</tr>
<tr>
<td>1 April 2008 – 31 March 2009</td>
<td>$102,922</td>
<td>$99,817</td>
</tr>
<tr>
<td>1 April 2009 – 31 March 2010</td>
<td>$106,473</td>
<td>$102,922</td>
</tr>
<tr>
<td>1 April 2010 – 31 March 2011</td>
<td>$110,018</td>
<td>$106,473</td>
</tr>
<tr>
<td>1 April 2011 – 31 March 2012</td>
<td>$111,669</td>
<td>$110,018</td>
</tr>
<tr>
<td>1 April 2012 – 31 March 2013</td>
<td>$113,768</td>
<td>$111,669</td>
</tr>
</tbody>
</table>

The maxima above differ as levies for employees are assessed on a current year’s basis, but for the self-employed the levy is assessed on prior year’s earnings. For this reason the figures for the self-employed trail the maximums for the current year as applicable to employees. However, if the self-employed person is using CoverPlus Extra, then a different maximum and minimum applies [see 20.45].

(2) Minimum

There is no minimum for employees and part-time self-employed people. Instead, those people pay levies based on actual earnings. The minimum level of cover only applies to a full-time self-employed person. A full-time person is a person who works on average at least 30 hours per week (whether or not as an employee). A full-time self-employed person who earns under the minimum will pay their levies based on the minimum figure (see table below) for that year, reduced by any earnings as an employee [see Example 4 below]. If the person has an accident and is incapacitated and unable to work, they will receive weekly compensation based on an amount of 80 per cent of the minimum.

The minimum specified amounts are:

<table>
<thead>
<tr>
<th>Earnings period</th>
<th>Persons 18 and over</th>
<th>Persons under 18</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 April 2003 – 31 March 2004</td>
<td>$16,016</td>
<td>$11,960.52</td>
</tr>
<tr>
<td>1 April 2004 – 31 March 2005</td>
<td>$16,640</td>
<td>$13,312</td>
</tr>
<tr>
<td>1 April 2005 – 31 March 2006</td>
<td>$17,680</td>
<td>$14,444</td>
</tr>
<tr>
<td>1 April 2006 – 31 March 2007</td>
<td>$18,720</td>
<td>$14,976</td>
</tr>
<tr>
<td>1 April 2007 – 31 March 2008</td>
<td>$19,760</td>
<td>$15,808</td>
</tr>
<tr>
<td>1 April 2008 – 31 March 2009</td>
<td>$21,320</td>
<td>$17,056</td>
</tr>
<tr>
<td>1 April 2009 – 31 March 2010</td>
<td>$23,400</td>
<td>$23,400</td>
</tr>
<tr>
<td>1 April 2010 – 31 March 2011</td>
<td>$26,000</td>
<td>$26,000</td>
</tr>
<tr>
<td>1 April 2011 – 31 March 2012</td>
<td>$26,529</td>
<td>$26,520</td>
</tr>
<tr>
<td>1 April 2012 – 31 March 2013</td>
<td>$27,040</td>
<td>$27,040</td>
</tr>
</tbody>
</table>

Before 1 April 2009, the minimum levy for persons under age 18 was 80 per cent of the adult minimum. The age was taken as at the last day of the income year under consideration. From 1 April 2009, there is no differentiation.

Example 1:
Joshua is a 25-year-old self-employed lawn mowing contractor. He works 45 hours per week on average. During the 2007-2008 year he derived net income from his business of $9,763. Joshua’s levy is calculated on the specified amount of $19,760.
Example 2:
Hyacinth, aged 42, works on average 20 hours per week as a self-employed flower arranger. The net income from her business for the 2007-2008 year was $11,428. Hyacinth’s levy is calculated on her actual earnings of $11,428 as her average hours are less than 30.

Example 3:
Max, aged 17, earned $8,714 as a self-employed handyman during the 2007-2008 year. He works an average of 35 hours per week. Max’s levy is calculated on the specified amount of $15,808.

Example 4:
During the 2007-2008 year Beryl, aged 23, earned $3,148 in wages and $8,649 as a self-employed knitting contractor. She works 35 hours per week on average. Because Beryl’s total earnings of $11,797 are less than the specified amount, her levy is calculated on the specified amount reduced by her employee earnings: $19,760 - $3,148 = $16,612.

20.40 CoverPlus for self-employed earners

CoverPlus is the standard default cover that all self-employed people have. It is automatically applied once a person starts self-employment and registers for GST with Inland Revenue. If a newly self-employed person does not register for GST immediately upon commencing self-employment (eg because their earnings are below the minimum threshold for GST registration), ACC is only notified when it receives the data from Inland Revenue based on the IR3 tax return.

CoverPlus is based on your previous year’s income for compensation purposes. If a person has an injury, in the standard case, they can receive up to 80 per cent of their previous year’s earnings for compensation. However, for people who are newly self-employed (ie the person is incapacitated in the first year of self-employment) or recently self-employed (people that are incapacitated in the year after the first year of self-employment) then the cover is:

(a) **Newly self-employed**: cover is the greater of the statutory minimum, or earnings from employment for 52 weeks prior to the period of incapacity. A newly self-employed person who has no earnings as an employee in the previous year or is a part-time person has no cover for loss of earnings under CoverPlus, not even the minimum (as that only applies to full-time people). This is irrespective of their earnings and despite the fact that they will still be liable for levies on their income. Newly self-employed, particularly those with no period of employment immediately prior to self-employment, should consider taking out CoverPlus Extra (if full time) or private loss of earnings insurance for their first year as a self-employed person.

(b) **Recently self-employed**: cover is established based on the earnings from self employment divided by the weeks the person was self-employed in the relevant year. However, earnings as an employee for the period of 52 weeks before the period of incapacity can also be taken into account if this increases the cover.

In all cases there is a one week stand down period on CoverPlus. The person will need to prove loss of earnings at the time of the injury to be eligible for compensation.

(1) **How CoverPlus levies are calculated**

Under CoverPlus, the previous year’s liable earnings are used to calculate both levies and entitlements, including weekly compensation. CoverPlus levies are calculated using:

(a) The liable earnings figure provided on the previous year’s IR3 tax return; and

(b) The appropriate classification unit and Work levy rate for ACC CoverPlus; and

(c) An Earner levy which covers all non-work injuries; and

(d) Residual Claims and Health and Safety in Employment levies.
(2)  **What is covered by the various parts of the CoverPlus levy**

<table>
<thead>
<tr>
<th>Levy name</th>
<th>What the levy covers</th>
<th>How it is calculated</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACC CoverPlus levy</td>
<td>Medical, rehabilitation and weekly compensation costs for injuries that happen at work</td>
<td>The classification unit rate × each $100 of liable earnings</td>
</tr>
<tr>
<td>Residual Claims levy</td>
<td>Provides funds for the ongoing costs of work injuries that occurred before 1 July 1999 and non-work injuries to earners before 1 July 1992. This levy is spread across all levy payers.</td>
<td>The Residual Claims levy rate × each $100 of liable earnings</td>
</tr>
<tr>
<td>Earner levy</td>
<td>Medical, rehabilitation and weekly compensation costs for any injury sustained outside work</td>
<td>The Earner levy rate × each $100 of liable earnings</td>
</tr>
</tbody>
</table>

Health and Safety in Employment levy

 ACC collects this levy on behalf of the Department of Labour. It is used to help fund Occupational Safety and Health.

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20.45 **CoverPlus Extra for self-employed earners**

CoverPlus Extra (CPX) is an alternative to the standard CoverPlus that self-employed are automatically covered under. CPX allows self-employed people to nominate a level of cover (eg $50,000 per annum), as opposed to being covered on their previous year’s earnings, as with the standard CoverPlus. It will give a guaranteed level of weekly compensation, agreed in advance with ACC, if someone is unable to work as a result of injury. CPX is not in addition to CoverPlus, it is instead of the latter.

**Note:** Levies for the compensation a person chooses are now based on that person’s individual occupation or main work task, rather than the industry classification unit of the employer company, as was the case previously. For example, a road freight company with two shareholder employees with one working in the office and the other driving the freight truck would previously have used the road freight classification unit rate 61100 for the CPX levy rate for both shareholder employees regardless of their individual occupation within that company. Now the individual occupation rate applicable for that industry can be used and the office manager would use the office administration classification rate 78540 and the truck driver 61100. A declaration of business activities form is required to be completed.

(1)  **Minima and maxima**

The minimum and maximum compensation people can receive changes from year to year. The CPX maxima and minima differ from the standard. Under CoverPlus Extra the minimum and maximum levies are based on 80 per cent of the statutory minima and maxima that relate to the current year [see 20.35].

Currently they are:

<table>
<thead>
<tr>
<th>2013 Calculation</th>
<th>Standard CPX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum</td>
<td>$21,632× 80% $17,305.60</td>
</tr>
<tr>
<td>Maximum</td>
<td>$91,015 × 80% $72,812</td>
</tr>
</tbody>
</table>

However, within these minimum and maximum amounts, the cover can be altered (raised or lowered) by between 40 per cent and 120 per cent of the average of the person’s last three year’s earnings to better fit a person’s circumstances, as illustrated in the examples below. However, the income can not drop below the minimum.
(2) **Levies and invoicing**

Under CPX people are required to pay two levies:

(a) *CoverPlus Extra*: Invoiced in advance and sent within two to four weeks of the acceptance being received by ACC and processed.

(b) *Residual and health and safety in employment (HSE) levies*: Invoiced when previous year’s liable earnings are received by ACC from Inland Revenue.

Because the residual claims and HSE levies are based on a client’s actual earnings that they declare in their IR3 tax return, people with ACC CoverPlus Extra will receive an additional invoice when they file their tax returns for these components only. For shareholder-employees this invoice goes to the employer company.

(3) **Who is eligible?**

People eligible for CPX are:

(a) Full-time self-employed and non-PAYE shareholder-employees; or

(b) Part-time self-employed and non-PAYE shareholder-employees, when the average earnings from the past three years are above the CoverPlus Extra minimum [see 20.35].

(4) **Different options under CPX**

CoverPlus Extra (CPX) provides greater flexibility and certainty for self-employed people by paying a predetermined level of weekly compensation in the event of an injury resulting in time off work. People receive 100 per cent of the amount of weekly compensation until they are fit to return to full-time work. Lower Levels of Weekly Compensation (LLWC) is an option that allows lower levels of compensation in return for a lower levy. Under this option the agreed weekly compensation decreases as the individual gradually returns to full-time work after an injury. Weekly compensation stops once they are able to work 30 hours a week. Part-time self-employed people are not eligible for this option as part-time self-employed people work less than 30 hours a week.

(5) **How CoverPlus Extra levies are calculated**

Under CoverPlus Extra (CPX), the agreed level of lost earnings cover is used to calculate both levies and entitlements (including weekly compensation). CPX levies are calculated using the:

(a) Agreed level of earnings cover; and

(b) The liable earnings figure provided on the previous year’s IR3 tax return for the residual claims and health and safety in employment (HSE) levy components; and

(c) The appropriate levy classification unit and work account levy rate for ACC CoverPlus Extra.

(6) **What is covered by the various parts of the CoverPlus Extra levy**

<table>
<thead>
<tr>
<th>Levy name</th>
<th>What the levy covers</th>
<th>How it is calculated</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACC CoverPlus Extra levy</td>
<td>Medical, rehabilitation and weekly compensation costs for injuries that happen at work.</td>
<td>The classification unit rate × each $100 of the agreed level of cover.</td>
</tr>
<tr>
<td>Residual Claims levy</td>
<td>Provides funds for the ongoing costs of work injuries that occurred before 1 July 1999 and non-work injuries to earners before 1 July 1992. This levy is spread across all levy payers.</td>
<td>The Residual Claims levy rate × each $100 of liable earnings.</td>
</tr>
<tr>
<td>Earner levy</td>
<td>Medical, rehabilitation and weekly compensation costs for any injury sustained outside work.</td>
<td>The Earner levy rate × each $100 of agreed level of cover.</td>
</tr>
</tbody>
</table>
Accident Compensation

<table>
<thead>
<tr>
<th><strong>Levy name</strong></th>
<th><strong>What the levy covers</strong></th>
<th><strong>How it is calculated</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Health and Safety in Employment (HSE) levy</td>
<td>ACC collects this levy on behalf of the Department of Labour. It is used to help fund Occupational Safety and Health.</td>
<td>5 cents × each $100 of liable earnings.</td>
</tr>
</tbody>
</table>

**Example 1:**
John is an engraver earning $100,000 per annum. Bridget, John’s daughter, runs the administration side of the business. The annual earnings is split 60/40. Under CoverPlus John would receive $48,000 and Bridget $32,000. However, under CPX the income can be split differently from that used for tax purposes to reflect the different earning capacities. In this case, John is the central income earner for the business. John and Bridget adjust the yearly compensation amounts so that if John has an injury and cannot work John will be paid $72,000 and Bridget $28,000.

**Example 2:**
Kelly started her own business. Her first year’s activities resulted in a net loss. Kelly suffered an injury and requires four weeks off work. As she made a loss she was only entitled to the minimum compensation as she has no income as an employee in the immediately prior year. If Kelly had taken up ACC CoverPlus Extra prior to injury she would have received compensation based on a pre-agreed amount.

### 20.50 Difference between CoverPlus and CoverPlus Extra

At a broad level the key differences between CoverPlus and CoverPlus Extra (CPX) are illustrated below:

<table>
<thead>
<tr>
<th><strong>CoverPlus</strong></th>
<th><strong>CoverPlus Extra</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 80 per cent of previous year’s earnings.</td>
<td>100 per cent of the weekly compensation as agreed with ACC.</td>
</tr>
<tr>
<td>Seven-day wait period before compensation starts.</td>
<td>Seven-day wait period before compensation starts.</td>
</tr>
<tr>
<td>Weekly compensation is reduced as hours of work increase.</td>
<td>Weekly compensation remains at 100 per cent until fully fit to return to work.</td>
</tr>
<tr>
<td>Proof of loss of income is required.</td>
<td>No proof of loss of income is required. Weekly compensation will be paid even when the business continues generating income.</td>
</tr>
<tr>
<td>Minimums and maximums apply.</td>
<td>Minimums and maximums apply.</td>
</tr>
</tbody>
</table>

CoverPlus Extra does cost a little more than CoverPlus. For self-employed and non-PAYE shareholder-employees comparing CoverPlus and CoverPlus Extra, the cost of CoverPlus Extra is not prohibitive compared to the advantages. The principal advantage is that CPX is based on 100 per cent of the agreed amount until the person is eligible to return to work full time. Thus, if a person is in receipt of CPX their weekly compensation will not reduce if the person’s business continues to generate income or the person returns to work in a part-time capacity.

With CoverPlus, weekly compensation will be reduced if the business continues to generate income or when there is a partial return to work. This is because CoverPlus is based on actual loss of earnings. This also means that if a person is off work beyond the end of their financial year, then an end-of-year wash up is undertaken to ensure that ACC has not overpaid weekly compensation to the person. In some cases then, CoverPlus weekly compensation can be seen as an interim payment with a year-end overpayment or underpayment adjustment required.

### 20.55 WorkPlace cover

WorkPlace Cover pays for the current and future costs of work-related injury claims that occur in the levy year. ACC WorkPlace Cover is the product name given to the weekly compensation payable to employees for work-related injuries and is funded from the work account.
(1) **How WorkPlace Cover levies are calculated**

The levies are calculated based on:

(a) Employees liable earnings as provided by the employer to Inland Revenue on the Employer Monthly Schedule (IR348); and

(b) The appropriate levy classification unit.

(2) **What is covered by the various parts of the WorkPlace Cover**

<table>
<thead>
<tr>
<th>Levy name</th>
<th>What the levy covers</th>
<th>How it is calculated</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACC WorkPlace Cover levy</td>
<td>Medical, rehabilitation and weekly</td>
<td>The classification unit rate × each $100 of liable earnings.</td>
</tr>
<tr>
<td></td>
<td>compensation costs for work-related</td>
<td></td>
</tr>
<tr>
<td></td>
<td>injuries.</td>
<td></td>
</tr>
<tr>
<td>Residual Claims levy</td>
<td>Provides funds for the ongoing costs of</td>
<td>The Residual Claims levy rate × each $100 of liable</td>
</tr>
<tr>
<td></td>
<td>work-related injuries that occurred</td>
<td>earnings.</td>
</tr>
<tr>
<td></td>
<td>before 1 July 1999.</td>
<td></td>
</tr>
<tr>
<td>Health and Safety in Employment</td>
<td>ACC collects this levy on behalf of the</td>
<td>5 cents × each $100 of liable earnings.</td>
</tr>
<tr>
<td>levy</td>
<td>Department of Labour. It is used to help</td>
<td></td>
</tr>
<tr>
<td></td>
<td>fund Occupational Safety and Health.</td>
<td></td>
</tr>
</tbody>
</table>

### 20.60 TimeOut cover for loss of earnings

A person ceases to be an earner after four weeks of leave without pay, even if the person remains in employment. To avoid a period when there is no cover (eg extended leave or a sabbatical) employees, and self-employed who take a break from work, can purchase loss of earnings cover from ACC known as TimeOut. The cover provides weekly compensation in the event of an injury during a break from paid work.

Cover under TimeOut is set at 80 per cent of a person’s earnings before they cease working. The cover provides weekly compensation for a period of up to five years. TimeOut has to be purchased while the person is still in employment or self employment or within one month of ceasing. TimeOut is purchased in blocks of three months up to a maximum of 24 months. However, it is not available for overseas travel if the person remains outside New Zealand for more than six months.

In the case of parental leave an employee may be eligible for weekly compensation if they are unable to return to work at the agreed date due to an injury suffered while on parental leave. This requires that there is a written agreement between the employer and employee that verifies the parental leave and the period of the leave. Otherwise, the TimeOut product could be considered for periods of parental leave.

Seasonal workers are an example of people who could utilise ACC TimeOut. With seasonal workers, unless they can show a pattern or seasonal work, periods of no work in an off season are not covered by the levy paid while working.

### 20.65 Shareholder-employees

A shareholder-employee is someone who is both a shareholder in the company and an employee of the company. For ACC purposes there are two categories of shareholder-employees: those who are paid through the PAYE system (as with any other employee) and those who are not. The latter type of shareholder-employee is not subject to PAYE on their remuneration and instead pays provisional tax. For ACC purposes these earners are referred to as non-PAYE shareholder-employees.

Non-PAYE shareholder-employees’ earnings are declared on the company tax return form IR4, which is the source of the information provided to ACC by Inland Revenue. Most non-PAYE shareholder-employees will not pay themselves a regular wage, and instead the level of their remuneration depends on the profit the company makes. The income or salary of the shareholder-employee is provisional income and subject to provisional tax in the usual manner.
Shareholder-employee remuneration is regarded as a payment made to a shareholder-employee for services they have provided, and as such is liable to ACC [see 20.25].

Shareholder-employees who are non-PAYE shareholder-employees can opt to use CoverPlus Extra as the basis for paying their ACC levies. In this case, the levy will be based on a pre-determined amount. The maximum earnings rules will apply [see 20.45]. This applies whether the shareholder-employee is a tax resident of New Zealand or a non-resident. Although the levies will apply to non-resident shareholder-employees, they will only get entitlement to ACC benefits if they were resident in New Zealand at the time of their injury.

The ability to use CPX is undoubtedly an advantage [see 20.50]. Until recently take up of CPX by non-PAYE shareholder employees was hampered because the premiums were technically not deductible by either the employer company or the shareholder employee. This was due to the fact that the CPX policy is in the name of the non-PAYE shareholder-employee and is billed by ACC to the non-PAYE shareholder-employee, not the company. Further, any compensation paid under CoverPlus Extra is regarded as “income from employment”. The result was that for the purposes of s DA 2, the employment limitation applied and the levies were not deductible. Further, if the company paid the levy on behalf of the non-PAYE shareholder-employee the payment was regarded as taxable income under s CE 1(b) as the levy is the liability of the shareholder-employee. See also Chartered Accountants Journal of New Zealand vol 81:11 (December 2000) at 46; vol 82:6 (July 2003) at 53; and vol 82:10 (November 2003) at 51.

However, in September 2010 ACC issued a statement to say that the deductibility issue had changed and that the work account levy component of the CPX premium would be deductible to the employer. The earner levy component remains non deductable. Inland Revenue confirmed this in their Agent’s Answer newsletter for November 2010. Further, it does not matter if the employer company pays the levy directly or by way of reimbursement. This is discussed in the Chartered Accountants Journal of New Zealand vol 89:11 (December 2010). The invoice for CPX will be modified to split the earner rate out, but for the present the following formula should be used:

\[
1.7245 \times 1.25 \times \text{cover amount}/100
\]

Example

\[
1.7245 \times 1.25 \times \$60,000/100 = \text{earner levy of } \$1293.37
\]

For non-PAYE shareholder-employees, the earnings for the residual claims levies are based on actual earnings and not the agreed amount. For this reason, these levies are billed separately. For non-PAYE shareholder-employees that do not opt to use CPX, the company will be billed for their WorkPlace Cover levy. However, the billing process differs from ordinary employees in that the income of the non-PAYE shareholder-employee does not go through the employer monthly schedule. Instead it is advised to ACC by Inland Revenue once the IR4 company return of income is processed. Thus there will be a provisional and year-end invoice. The residual claims levies will also be invoiced when the actual earnings are known.

20.70 Mixed earners

A mixed earner is a person who derives income from both employment and self-employment. ACC is able to identify a mixed earner based on the information received from Inland Revenue. If a self-employed person has declared income in the following key-points on the IR3, ACC treats them as mixed earners:

(a) Gross earnings as an employee (key point 11B);
(b) Earnings not liable for levy (key point 11C); and
(c) Shareholder-employee salaries (key point 20)

When a person is a full-time earner and has mixed earnings, say for example, from a partnership and a salary, then the following applies:

(a) If the earnings as a self-employed and employed person exceed the maximum, the ACC levy will be based on the lesser of the maximum less earnings as an employee or the self-employed earnings.
(b) If the earnings as a self-employed and employed person do not exceed the maximum, the ACC levy will be based on the self-employed earnings.

(c) If the earnings as a self-employed and employed person are less than the minimum the levy will be payable on the minimum amount less the income from employment [see Example 4, 20.35].

20.75 Partnerships

A partner who actively works in the partnership business is liable to pay levies on their share of the partnership income for the year [see 20.25]. A partner who has capital in a partnership and shares in its profits without taking any part in the management or day-to-day running of the business (that is, a sleeping partner), is not liable for the levies on their share of the partnership profits as this amount does not come about from personal exertion and would not cease if the partner was incapacitated through an injury [see TIB vol 7:3 (September 1995) at 13; TIB vol 13:3 (March 2001) at 17].

20.80 Private domestic workers

A private domestic worker is someone who works in someone else's home or garden. There are a few different factors which apply to a private domestic worker:

(a) The work must not be regular full-time work;
(b) The work must not be related to the other person’s business;
(c) The other person must not be making tax deductions for the private domestic worker (eg cannot be employing them through PAYE);
(d) The private domestic worker files an IR56 tax return and pays PAYE to Inland Revenue in respect of their earnings. The earnings information disclosed on the Employer Monthly Schedules provided to Inland Revenue is provided to ACC for invoicing;
(e) There are about 2000 private domestic workers. Some of these may be caring for someone who is off work on ACC.

Private domestic workers are covered by WorkPlace Cover as they are taken to be their own employer as they pay their own PAYE to Inland Revenue. Private domestic workers are not sent an estimate invoice unlike other employers. The year-end invoice will include the WorkPlace Cover levy and the residual and HSE levies. The Earner levy for private domestic workers is collected via their PAYE.

20.85 Business industry descriptions and classification units

ACC gives every business an “industrial classification unit” based on the main type of work it does. ACC group similar businesses this way to ensure that the costs of claims are shared fairly among the industries responsible for those costs. Depending on the actual number and cost of injury claims made each year, classification units can move into a higher-rated or lower-rated business industry description, which leads to a higher or lower levy.

(1) Business industry description

A business industry description is a way of classifying a business by the main activity it is involved in. ACC use business industry descriptions to determine classification units. Each business industry description has its own unique business industry code. Currently, there are 117 business industry descriptions covering 534 classification units.

(2) Classification unit

A “classification unit” (CU) represents a group of businesses with a similar risk of workplace injury. Each CU has an ACC levy rate, which is used to calculate ACC levies for workplace injury cover and residual claims. Each CU has its own unique CU code. A CU can have a large number of businesses or just a few. The CU information is also reflected on the ACC invoice.
(3) Importance of choosing the correct business industry description
Choosing the correct business industry description means records at Inland Revenue and ACC will be set up with the right information, and invoices will be calculated correctly. In most cases, this will relate to the primary business (that is, the goods produced or the services provided). There may be more than one appropriate CU for your client’s business. If so, you use the CU with the highest levy rate, unless your client is eligible to use multiple CUs. In some cases there may not be a CU for an activity. In these situations it may be necessary to contact ACC to have one established.

(4) What to do if the business involves two or more business activities
If your client is Self-employed, and you are unsure which description to use. Then It will be necessary to call the ACC Business Service Centre.
An employer with employees carrying out different tasks, Check the “multiple description guidelines” on they will need to choose a single description reflecting their main business activity, if they are involved in two or more Website. business activities.

20.90 Employer invoicing
Employers are invoiced for ACC under a policy called ACC WorkPlace Cover [see 20.55]. Employers will receive two invoices each year: one an estimate invoice and the other a year-end invoice. The reason for invoicing twice is because employers are charged levies based on their actual liable earnings for a particular year. However, because actual liable earnings are not determined until year end, and they are invoiced in the current cover period, it is necessary to base the current period invoice on an estimate (provisional invoice) based on their previous year’s information. When ACC receives details of the actual liable earnings from Inland Revenue, it sends a wash up (year-end) invoice if there is a difference. For close companies (when shareholder-employee remuneration has not been subject to PAYE, whether the shareholder-employee pays CPX or not) the employer invoice will include an invoice for earners residual levy and any earner levy deductions for amounts for the prior year ending 31 March. This is because these levies are based on actual earnings for the period. The GST is included in the earner levy rate and not invoiced as such.

(1) Provisional invoices
ACC calls employer invoices provisional because they are an estimate based on previous year’s liable earnings, adjusted for expected wage and salary increases. The provisional invoice should be paid by the due date to avoid additional charges. However, if an employer believes the information ACC used to calculate the provisional invoice is incorrect (because the business activities or the liable earnings have changed); the employer can request a reassessment. The request must be lodged within 30 days of the provisional invoice although the provisional invoice is still payable. A reassessment can be requested by either contacting ACC or completing and sending ACC the (ACC1767) Changes to your business information (employers).

(2) Final debt adjustment
To ensure that employers pay no more or less than they should, ACC issues a final debt adjustment when they have the actual liable earnings for the employer. The final debt adjustment will be either a credit or debit amount. Final debt adjustment and provisional invoices are sent at the same time each year (between July and August) — a final debt adjustment for last year and a provisional invoice for next year. Residual levies and earner levies for non-PAYE shareholder-employees will be billed on this invoice. If there is a credit on your client’s account from a reassessment or a final debt adjustment, the refund can be either paid out or credited to other ACC account balances. Interest will be paid on credit adjustments due over $1,000.
20.95 Levy Discount schemes

(1) Workplace Safety Discounts

*Workplace Safety Discounts* (WSD) is an incentive programme offered to self-employed people and small businesses in the seven industry sectors with the highest number of work-related injuries: namely agriculture, forestry, fishing, construction, road freight transport, waste management and motor trades.

The workplace safety discounts programme aims to improve workplace safety through offering levy discounts to small employers and self-employed people who can demonstrate capability in hazard management, staff training in safe work practices and emergency readiness. Businesses and self-employed people in the programme are given a 10 per cent discount on the work account component of their levies. The discount is valid for three years from application, though an annual declaration that operations remain the same will be required.

The criteria to apply are:

(a) Liable earnings of $450,000 or less — that is up to about 10 full-time staff; and
(b) Relevant “prior experience” in managing health and safety issues in their industry; or
(c) Attend a free industry specific training programme that covers hazard management for the sector in which the small business or self-employed person operates (see the ACC website for details).

To participate in the workplace safety scheme, the business or self-employed person needs to complete a self assessment (which can be downloaded from ACC’s web site), that shows they have sufficient capability in hazard identification and management, injury and incident investigation, emergency readiness, and in training employees. Included in the self assessment is the business owner’s description of how their business does:

(a) Hazard identification and management (ACC has selected the most common hazards in each industry for the self assessment);
(b) Incident investigation;
(c) Emergency readiness.

After the assessment is complete, the small business can send the results to ACC and ask for a discount on their ACC levies.

(2) Workplace Safety Management Practices

*Workplace Safety Management Practices* (WSMP) is a programme that was developed to recognise employers who have established health and safety systems and good practices in injury prevention. In return for having systems and processes for managing and improving workplace safety, employers can receive discounts on their ACC Workplace Cover Levy.

The benefits are:

(a) Gives employers an externally audited, national safety framework to work to;
(b) Proves their safety commitment to staff;
(c) ACC Levy discounts; and
(d) Reduces work injuries.

There are three levels of discount that can be achieved depending on the level of their workplace practices:

(a) Primary: 10 per cent discount;
(b) Secondary: 15 per cent discount; and
(c) Tertiary: 20 per cent discount.

An independent audit takes place and the outcome of the audit will determine which level of discount the customer will receive. The discount will apply for 24 months, starting from the first month after the audit takes place.

The application is a three-step process:
(a) Step 1: Complete a self assessment (this can be downloaded from the ACC website)
(b) Step 2: Complete the application form (also available from website)
(c) Step 3: Undertake an independent audit. This is paid for by ACC but the employer can select an auditor from an approved list and arrange for the audit to be completed.

3 ACC partnership programme

Employers have an option to join the ACC Partnership Programme. This provides levy discounts to employers when they take responsibility for their own workplace health and safety, injury management and rehabilitation of employees’ workplace injuries.

20.100 Accidental death claims and entitlements

A person’s death is covered by ACC entitlements if all of the following three criteria are met. A person must have suffered:

(a) An accident;
(b) A personal injury; and
(c) Death that is a direct consequence of the personal injury.

Entitlements include:

(a) Funeral grant: An estate is eligible for a funeral grant upon confirmation of cover by ACC for the actual cost of the funeral up to the current indexed rate for the date at which the person died. The deceased claimant’s estate must provide an itemised account that shows the actual costs of the funeral. This includes costs related to the burial or cremation, and any associated ceremonies. These can be standard and basic costs, as well as costs specific to the claimant’s ethnic and religious requirements.

(b) Survivor’s grant: A survivor’s grant is a one-off non taxable payment to a dependant of the deceased as compensation. A survivor’s grant can be paid to a person who qualifies as a surviving spouse or a child under the age of 18 years.

(c) Childcare: Childcare is a weekly payment towards the cost of supervising or caring for the dependant children of the deceased. Childcare can be paid for a child that qualifies as a dependant child of the deceased. The child must live in New Zealand and be under the age of 14 at the date of death. Childcare is paid to the person who arranges care for the child. This is often the surviving spouse but may be a guardian or CYFS. Childcare is never paid to the child themselves. There are three rates of payment for childcare, which are calculated on the number of qualifying dependants:

(i) A single weekly amount for when there is one child;
(ii) When there are two children, a single amount paid for each child; or
(iii) When there are three or more children, a single amount pro-rated between all the qualifying dependant children.

(d) Weekly compensation: Weekly compensation is a payment made to the dependants of a deceased person if the deceased was an earner, to compensate them for the impact of the deceased person’s loss of income. Weekly compensation payable to a surviving spouse, child or other dependant is based on a proportion of the weekly compensation that would have been paid to the deceased claimant had they survived with full incapacity. If there are a number of dependants, the total compensation payable for all dependants must not exceed the compensation that would have been paid to the deceased. In this situation, a pro-rata calculation is performed. Weekly compensation is payable to surviving dependants from the date of the deceased’s death. There is no first week stand down period, even if the deceased suffered a non-work injury. There are rules around how long each dependant can receive an entitlement to weekly compensation.

Payments to a spouse continue until the latest of the following dates:

(a) The end of five consecutive years from the date on which the entitlement first became payable;
Accident Compensation

(b) The date the youngest child of the deceased turns age 18 — this criteria only applies if the spouse is continuing to provide care to that child;

(c) The date the spouse no longer provides care for the children of the deceased who are under the age of 18 years; or

(d) The date the spouse no longer provides care for any person who qualifies as an other dependant.

20.105 Taxation of accident compensation [ss CF 1, CW 35]

(1) Taxable income
The following forms of accident compensation are liable for income tax [s CF 1]:

(a) Payments of earnings-related compensation under the Accident Compensation Act 1982;

(b) Payments under s 80(4) of the Accident Compensation Act 1982;

(c) Payments of the following under the Accident Rehabilitation and Compensation Insurance Act 1992 (ARCIA 1992):
   (i) Vocational rehabilitation allowance;
   (ii) Compensation for loss of earnings;
   (iii) Compensation for loss of potential earning capacity;

(d) Payments of weekly compensation under the Accident Insurance Act 1998 (AIA 1998);

(e) Payments of compensation for loss of earnings or loss of potential earning capacity, as it relates to work related personal injury, under policies of personal accident or sickness insurance under s 188(1)(a) of the AIA 1998;

(f) Payments of weekly compensation by the ACC under the Injury Prevention, Rehabilitation, and Compensation Act 2001 (IPRCA 2001); or

(g) From 1 July 2008, personal service rehabilitation payments [see 20.110] for claimants under the IPRCA 2001.

These taxable compensation payments are also included in income when calculating the family assistance tax credits.


Compensation payments are included in the definition of “salary or wages” for the purposes of student loan repayments. Therefore, if a person with a student loan receives accident compensation, and has total income over the repayment threshold, a deduction of 10 cents in the dollar is made from the compensation payments by ACC [see TIB vol 7:3 (September 1995) at 28, and 1380 STUDENT LOANS].

(2) Exempt income
Payments of the following kinds, made under Part 5 or Part 13 of the AIA 1998, or Part 11 of the IPRCA 2001, are exempt from income tax [s CW 33]:

(a) Payments to an insured person for treatment or rehabilitation;

(b) Independence allowance;

(c) Funeral grant;

(d) Survivor’s grant; or

(e) Childcare payment.
20.110 Attendant care payments [ss CE 12, CF 1, CW 33, CW 35, DF 4, LB 7, LB 8, RD 3]

From 1 July 2008, ACC Payments made by ACC (or an employer that is an accredited employer under the IPRCA 2001) for payments for the following services are subject to a scheduler payment tax of 15 cents (12.5 cents from 1 October 2008) in the dollar under sch 4, Part I:
(a) Attendant care;
(b) Home help;
(c) Childcare;
(d) Attendant care services related to training for independence;
(e) Attendant care services related to transport for independence.

Inland Revenue has always considered ACC’s payments to caregivers to be “earnings”. The change in tax law requires ACC to deduct tax at source from these payments.

If a person (ACC claimant) is paid by ACC, and then on-pays their caregiver:
(a) 12.5 per cent (15 per cent before 1 October 2008) tax will be deducted from the claimant’s ACC payments;
(b) If the ACC claimant fully uses the after-tax payment received to purchase care, the total amount of the payment will be treated as exempt income to the claimant. The amount paid to the caregiver, together with the amount of the withholding tax will be taxable to the caregiver, with the tax credit available to the caregiver to be offset against his or her tax liability. If part of the amount is retained by the claimant, both the claimant and the caregiver will have taxable income; and
(c) If the claimant fails to give ACC their IRD number, ACC will be required to deduct tax at the non-declaration rate.

Example 1:
Bruce was involved in a car accident (post-1 October 2008) that reduces his ability to care for himself. ACC assesses his entitlement to attendant care at $500 a week. ACC deducts withholding tax of $62.50 from this and pays Bruce a net amount of $437.50. Bruce fully uses this to pay Lorraine to assist him. Because Bruce has fully used the amount he received, his payment is treated as exempt income under CW 35. Lorraine’s income for tax purposes is the amount received ($437.50) plus the amount of the withholding tax (under s CE 12) that was deducted ($62.50), making a total of $500. Lorraine is given credit for the tax deducted (the $62.50) to offset against her tax liability.

If the ACC claimant retains part of the payment, that part of the payment is taxable income to the ACC claimant, with a deduction allowed for the pre-tax equivalent amount. The tax credit is apportioned between the two.

Example 2:
In Example 1, instead of using the full amount received to pay for a caregiver, Bruce arranges for his friend Cliff to assist him for $350 a week. Bruce is taxable on the $500 payment less a deduction equal to the pre-tax equivalent of the amount he paid Cliff, which is $400, making his net taxable income $100. Bruce receives a proportional amount of the total tax deduction of $62.50, which in this example is $12.50. Cliff is taxable on the amount he received ($350), plus a proportion of the tax credit, which in this example is $50.00, making his total taxable income $400, with a tax credit of $50.

If caregivers are paid directly by ACC, they:
(a) Will have 15 per cent (12.5 per cent from 1 October 2008) tax deducted from their payments, unless the caregiver is a company or local / public / Maori authority.
(b) Need to give ACC their IRD number otherwise ACC is required to deduct tax at the non-declaration rate.
(c) Have the option of providing ACC with a “certificate of exemption” (obtained from Inland Revenue) so zero per cent tax is deducted.
(d) Have the option of providing a “special tax certificate” (obtained from Inland Revenue) for a different amount of tax to be deducted.

Note: If caregivers are employed by an agency, this tax law change will not affect them.

An ACC claimant whose only income is from personal service rehabilitation payments will not be required to file a tax return if their total income for the tax year does not exceed the income threshold and tax was withheld at the respective threshold rate (eg from 1 July 2008 to 31 March 2009, $14,000 at 15 per cent or 12.5 per cent) [TAA, s 33C].

Changes to the first taxable income threshold and respective tax rate are outlined below:

<table>
<thead>
<tr>
<th>Period</th>
<th>Income Threshold</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 April 2008</td>
<td>$9,500</td>
<td>15%</td>
</tr>
<tr>
<td>1 July 2008</td>
<td>$14,000</td>
<td>15% or 12.5%</td>
</tr>
<tr>
<td>1 April 2009</td>
<td>$17,000</td>
<td>12.5%</td>
</tr>
<tr>
<td>1 April 2010</td>
<td>$20,000</td>
<td>12.5%</td>
</tr>
</tbody>
</table>

20.115 Interest paid by ACC [ARCIA 1992, s 72]

Interest paid by ACC under s 72 of the ARCIA 1992 is not assessable income for income tax purposes. It is a penalty for administrative delay and inefficiency, and does not fall within the definition of “interest” in s YA 1 because it is not paid for money lent. The interest payments also do not come within the common law concept of income because there is no periodicity, regularity or recurrence, and the payment does not result from business activities, a deliberate seeking of profit, or a performance of services: Commissioner of Inland Revenue v Buis (2005) 22 NZTC 19,278 (HC). Inland Revenue take a different view on the law in this situation, and are reluctant to accept the position in that case [see Exposure draft QB0033: Payments made in addition to financial redress under Treaty of Waitangi Settlements].

20.120 Deductibility of levies and premiums [ss DA 1, DA 2, EF 3]

ACC levies are deductible if the general permission [s DA 1] is satisfied. Employer levies are deductible as part of the costs of employing staff. Like salary and wages, there is a definite nexus between the expenditure incurred and carrying on a business in order to derive income. However, a question could be raised on whether any of the levies which relates to wages paid to staff involved in constructing a capital asset should be capitalised and included in the cost of the asset, rather than being immediately deductible: Christchurch Press Co Ltd v Commissioner of Inland Revenue (1993) 15 NZTC 10,206 (HC) [see 1230.10].

No tax deduction is available to employees for expenses incurred in deriving employment related income and this also applies to the ACC earner levy [s DA 2(4)].

Earner levies paid by self-employed people and partners are deductible. These may be claimed as a tax deduction because weekly compensation is taxable income. There is a nexus between the expenditure and deriving the income. There is a similar analogy here to the deduction available for accident and sickness insurance premiums.

Earner levies paid by shareholder-employees are not deductible, whether they are non-PAYE shareholder-employees or not. They are not deductible to the company: the levy is either a deduction from salary and subject to the employment limitation or are paid directly by the non-PAYE shareholder-employee through their CoverPlus Extra policy [see 20.65].

If deductible, the deduction is allocated to the income year in which the levy becomes due and payable [s EF 3(1)]. If a deduction for an ACC levy has been allocated to an income year earlier than the income year in which the levy is due and payable, and the CIR is unable (because of the time bar [TAA, s 108]) to amend the assessment for that year, the deduction is allocated to the earlier year [s EF 3(2)].

When the ACC levy is due and payable on the taxpayers terminal tax date, and their balance date falls between 1 October and 6 April (inclusive), and the tax return is linked to a tax agent, then the levy is treated as if it
was due and payable on the terminal tax date of someone who does not have a tax agent (ie two months earlier).

**Example:**
A self-employed person has a 31 March balance date and the IR3 is completed and filed by a tax agent. The earners account residual claims levy and residual claims levy for the year ended 31 March 20X1 is required to be paid on or before 7 April 20X2 which is the date when they are due and payable. Although this falls within the year ended 31 March 20X3, for the purposes of determining when the levies are deductible, they are treated as being due and payable on 7 February 20X2 which falls within the year ended 31 March 20X2.

**20.125 Treatment of GST on levies and premiums**

The provision of accident compensation is a taxable supply and GST is imposed on the levies as a consequence [see 580.07, 580.10].

Employers are able to claim an input tax credit for the GST component of the residual claims levy if they are registered for GST and hold the relevant tax invoice [see 580.80]. If they are not registered, they can claim a deduction against income for the whole of the levy, including the GST component. Employers cannot claim an input tax credit for the GST component of earner levies deducted from employees’ earnings because the GST is imposed on the employee, not on the employer.

Self-employed people who are registered for GST can claim an input tax credit for the GST component of levies if the hold the relevant tax invoice. If they are not registered, they can claim a deduction against income for the whole of these levies, including the GST component.
Chapter 30
Advertising

30.10 Advertising expenditure [ss DA 1, EA 3]
Generally, advertising expenses are deductible in the income year in which they are incurred [ss BD 2, DA 1], but they are subject to the prepayments rules [see 1140 PREPAYMENTS]. Under s EA 3, any prepaid expenditure (such as prepaid advertising) as at the end of an income year must be added back to assessable income for the year. It may then be deductible in the following income year.

However, Determination E12 [see 1140.70] allows prepaid advertising expenditure to be deducted in full in the income year it is incurred if the total of all prepaid advertising is less than $14,000 and the expenditure will have expired within six months after balance date. There is an overriding requirement that if the expenditure has been treated as prepaid for financial reporting purposes, then it must be treated as prepaid for income tax purposes.

A private company’s expenses incurred in advertising and sponsoring the go-kart racing activities of its major shareholder were held deductible:
TRA Case L7 (1989) 11 NZTC 1,052.

The cost of hoardings and permanent signs is not deductible [s DA 2(1)] and should be capitalised and depreciated:
TRA Case H1 (1986) 8 NZTC 101. Repairs and maintenance to hoardings and permanent signs is deductible, as is any loss on discarding them [see 1230 REPAIRS AND MAINTENANCE].

There may be other instances when advertising expenditure may be subject to the capital limitation [s DA 2(1)]. In Associated Newspapers Ltd v Federal Commissioner of Taxation (1938) 1 AITR 403 (HCA), a distinction was illustrated between capital and revenue:

“a profitable enterprise such as the sale of a patent medicine may depend almost entirely on advertisement. In the beginning the goodwill may have been established by a great initial outlay upon a widespread advertising campaign carried out upon a scale which it was not intended to maintain or repeat. The outlay may properly be considered to be of a capital nature. On the other hand the goodwill may have been gradually established by a continual advertisement over a period of years growing in extent as it proved successful. In that case the expenditure upon advertising might be regarded as an ordinary business outgoing on account of revenue.”

In such cases, if an amount on account of advertising was held to be subject to the capital limitation, this could constitute blackhole expenditure, in the sense that no tax relief is available for this outlay, whether by way of deduction, depreciation or amortization.

An advertising agent may not deduct the cost of placing advertising at the time a non-cancellation period commenced that was before the advertisement was published, because at the start of the non-cancellation period the taxpayer was not subject to the liability: Ogilvy & Mather Pty Ltd v Federal Commissioner of Taxation (1990) ATR 841, 90 ATC 4,836 (FCA).

Advertising expenditure that is incurred by way of entertainment could potentially be subject to the limitation rules [see 350 ENTERTAINMENT EXPENDITURE]. However, it will not generally be subject to the limitation rule when the expenditure is incurred mainly to advertise or promote a person’s goods or services to the public and no employee, existing business contact or associated person has a greater opportunity to enjoy the entertainment than the public generally [s DD 5].

The supply of advertising services to a non-resident is zero-rated for GST purposes if the service is supplied contractually for and to the non-resident who is outside New Zealand at the time the service is performed [see 580.42].
**30.20  Gifts** [ss DB 41, LD 1, LD 2, LD 3]

Individuals (whether in business or otherwise) making gifts or donations to any society, institution, association, organisation or trust that applies funds for charitable, benevolent, philanthropic or cultural purposes may qualify for a tax credit under s LD 1. Generally, the donor is unable to claim the tax credit if the donor receives any benefit in return for the donation [see 1395.75, TIB vol 23:7 (August/September 2011) at 2–3]. The amount of the tax credit is one-third of the total of all charitable or other public gifts, made by the person in a tax year.

Under s DB 41, companies may claim a deduction for charitable or other public benefit gifts made to any society, institution, association, organisation or trust described in s LD 3(2) or listed in sch 32 of the ITA 2007. Section DB 41(4) clarifies that the deduction rule for gifts supplements the general permission and is subject to the general limitations.

**30.30  Sponsorship** [ss BD 2, DA 1]

Sponsorship expenditure is expenditure that a taxpayer intends will promote their business in some way, but that will also benefit the recipient or other person in some manner other than by the receipt of ordinary income.

There are no specific rules that apply to sponsorship expenditure. The general permission and general limitations are the key statutory rules.

IRD has issued an interpretation statement **Deductibility of sponsorship expenditure** [see TIB vol 14:9 (September 2002) at 33-49]. The interpretation statement defines sponsorship expenditure as expenditure that will promote the payer’s business in some way, but that the recipient, or some other person, will also benefit in some manner other than by the receipt of ordinary income from business or income-earning activities. The interpretation statement principally analyses the general rules of deductibility, which includes an analysis of capital and private limitations, with some specific cases on sponsorship considered. The statement recognises that sponsorship expenditure may differ from other expenditures in that some benefit may accrue to the recipient of the expenditure.

The statement confirms that sponsorship expenditure will be incurred under s DA 1(1), when a nexus (ie connection) exists between the expenditure and the taxpayer’s assessable income. Whether such a nexus exists depends upon the character of the advantage sought by the taxpayer in incurring the expenditure. This in turn requires an analysis of the taxpayer’s purpose, which in turn requires an objective analysis of the surrounding circumstances, including the effect of the expenditure. In relation to expenditure incurred in the course of carrying on a business under s DA 1(1)(b), expenditure will be deductible where it is dictated by the business ends to which it is directed, those ends forming part of or being truly incidental to the business.

In order for the nexus test to be satisfied, the taxpayer must show that they intended that the business would be promoted by incurring the sponsorship expenditure.

The statement highlights the following four factors as relevant evidence in this regard:

(a) The specific terms of the sponsorship arrangement. For example, is there a specific requirement for the recipient to promote the taxpayer’s business? What is the extent and prominence of the business exposure specified in the agreement?;

(b) The place of the sponsorship arrangement in a coherent marketing strategy. For example, if a business’s market research has identified potential customers that frequently attend cultural events, then part of its marketing strategy may be to sponsor such events in return for its name and products being promoted during the event;

(c) The relationship between the market or potential market exposure capable of being reached and the taxpayer’s business. For example, market exposure at a tennis tournament is directly related to the business of a sports equipment retailer; and

(d) The relationship between the expenditure and the resulting income derived (ie can it be shown that the expenditure resulted in income being derived). For example, the sale of 10 tractors at an agricultural field-day, by a tractor manufacturer sponsoring the event in return for being able to
display the tractors, shows a direct relationship between the sponsorship expenditure and the derivation of income.

Sponsorship expenditure will be incurred under s DA 1(1)(b) when the expenditure is incurred by the taxpayer in the course of carrying on a business for the purpose of deriving the taxpayer’s assessable income, where the expenditure is dictated by the business ends to which it is directed. An example of this may be sponsorship expenditure required by the type or nature of the business, or in terms of a franchise or license agreement. This type of expenditure requires a determination of the character of the advantage sought by the taxpayer in incurring the expenditure and the relationship to the business.

Voluntary expenditure (a term introduced in the interpretation statement) may be deductible provided it is directed to business or income-earning ends.

The quantum of the expenditure is not material to the issue of whether or not it is deductible, except when there are associated party or avoidance concerns.

By the very nature of sponsorship expenditure, a third party may benefit from it. The person benefitting may be an unrelated arms-length recipient, or could be a principal shareholder and director in the company making the payment. When the recipient of the sponsorship is associated or related to the entity making the payment, the private limitation [s DA 2(2)] will need to be considered.

A New Zealand case in which there was evidence of a direct relationship between the sponsorship expenditure and the taxpayer’s income was TRA Case P16 (1992) 14 NZTC 4,107. The taxpayer in this case was a national courier that had acquired and raced a Jaguar motor car, having marked it with the company’s logo. Evidence that showed that there was a marked increase in turnover as a result of the racing promotion supported the conclusion drawn by Judge Keane that the related revenue expenditure was deductible.

Other relevant considerations in any analysis on deductibility will include the general limitations in s DA 2, such as the capital and private limitation. The Courts have developed a number of tests for distinguishing between capital and revenue expenditure [see 230.35]. The interpretation statement in TIB vol 14:9 (September 2002) at 43 also provides guidance. In that statement the CIR observed that the “identifiable asset” test is the most important in identifying sponsorship expenditure that is of a capital nature.

If sponsorship expenditure is incurred in relation to depreciable property, a depreciation deduction will be available under s DA 1 and subpart EE [see 250 DEPRECIATION].

A deduction for sponsorship expenditure is not prohibited if a private or domestic benefit is merely incidental to the payer’s income-earning or business activity. However, where it is the intention of the taxpayer that a private or domestic benefit results from part of the expenditure, apportionment (between deductible and non-deductible portions of the expenditure) will be required, or in the case of a company, the dividend rules may need to be considered. TRA Case L7 (1989) 11 NZTC 1,052 is a further example of sponsorship expenditure and the relationship to business income. In this case, the proprietor of a radiator repair business was able to satisfy the TRA that a nexus existed between the expenditure on go-kart racing and promoting the radiator repair business. Judge Barber stated:

“I am satisfied that there was a sufficient link between the expenditure and the income earning process of the radiator manufacturing and repair business, with regard to the entire expenditure and not merely to 50 per cent of it.”

TRA Case L7 and TRA Case P16 can be contrasted to TRA Case P73 (1992) 14 NZTC 4,489 which, although a GST case, highlights the circumstances when the private benefit obtained from the sponsorship may be considered to be more than merely incidental.

The deduction for sponsorship expenditure available in any particular income year may be limited to the portion that relates to that income year by ss BD 4(2) and EA 3 [see 1140 PREPAYMENTS].

Example 1:
A contracting company sponsors the local rugby team. Under the terms of the sponsorship agreement, which covers the year to 31 March, the contracting company agrees to pay an amount up-front towards the team’s running costs. In return, the team agrees to display the company’s business logo on all rugby uniforms, bags and vehicles used by the team during the year. The expenditure incurred by the company will be fully deductible under the general permission [s DA 1]. The requirement that the team display...
the company’s business logo on the uniforms, bags and vehicles is a strong indicator that the expenditure was incurred to promote the company’s business and is therefore deductible.

**Example 2:**
Suppose the company (in Example 1), also agreed to reimburse the team for the purchase of their van (ie the team owns the van), provided the business logo is prominently displayed on it. Alternatively, what if the company purchased the van, retaining ownership of it, but allowing the team full use of it provided the company’s business logo is prominently displayed on it. If the company reimburses the team for the purchase of their van, although the van is a capital item to the team, the capital limitation does not apply to the expenditure since the company does not own the van. This result is consistent with the company gifting money and the team using the money to purchase both its capital and operational needs. Therefore, no enduring asset results to the company from this expenditure. However, if the company purchased the van and retained ownership of it, the capital prohibition [s DA 2(1)] would apply as the expenditure results in an enduring asset (ie the van) owned by him. A deduction to the company for depreciation may be allowed under subpart EE.

**Example 3:**
Jenny is in business as a scuba-diving instructor. She enjoys horse riding and horse riding competitions. She decides to organise a gymkhana with prizes being given for the winning rider. She arranges for a billboard to be erected at the site of the competition with her business name and contact details on it. She expends a total of $2,000 in arranging the competition. In this case, Jenny’s scuba-diving instructing business bears no relationship to horse riding. The attendees are not a natural audience for scuba-diving promotion so as to reasonably form a potential market. This, considered with the fact of Jenny’s private enjoyment of horse riding, strengthens the conclusion that there is no identifiable nexus between the expenditure and her business. While there is some business exposure in the form of a billboard, the expenditure on the competition was likely to have been incurred for private enjoyment, with any business promotion being incidental to that private enjoyment purpose. On this basis, and in the absence of further evidence as to Jenny’s purpose in incurring the expenditure, no deduction would be allowed for expenditure on organising the competition. However, Jenny could take a deduction for the billboard, which, depending on the nature of the billboard, could be by way of depreciation.

**Example 4:**
John is a shareholder-employee of a marine products supplier, MPS Ltd. His hobby is to race yachts. MPS Ltd purchases a yacht, which John races in various yachting competitions. The company’s name and logo is painted on the hull of the boat. Here, a physical asset is acquired by the business and therefore no deduction is allowed by reason of the capital limitation in s DA 2. However, because the company’s name is displayed on the yacht, and MPS Ltd’s business of supplying marine products would be potentially promoted in a yachting competition, a deduction for depreciation will be allowed under subpart EE. The fact that John enjoys yachting does not preclude a depreciation deduction being allowed. The other expenses of yacht racing, will also be deductible.
Chapter 40
Agency

40.10 Agent’s obligations and rights generally ......................................................... 29

An agent is a person declared by the ITA 2007 to be an agent for the purposes of income tax [s YA 1]. A person who is an agent (as defined) is treated for the purposes of the ITA 2007 and the TAA as an agent of another person in relation to the tax obligations of that other person [s HD 1(1)].

For income tax purposes, a principal and an agent are jointly and severally liable for the tax obligations related to the agency. The CIR may issue an assessment for the same tax to both agent and principal, and both are liable in relation to the tax assessed [s HD 2].

Where a principal derives income through a business carried on in New Zealand by an agent then, for the purposes of sections HD 8 to HD 27 [see 40.20], the agent must:

(a) Make the assessments that their principal is required to make;
(b) Provide all returns their principal is required to make under the TAA; and
(c) Satisfy the principal’s income tax liability.

If more than one person is liable as agent in relation to the same tax, those persons are jointly and severally liable. An agent is treated as a separate person in their capacity as agent. Only tax credits or exemptions to which the principal is entitled may be claimed in relation to agency income [s HD 3].

The principal remains liable for their own tax obligations and is not released from them merely through the existence of an agency. This means that if the agent fails to fulfil their statutory obligations, the onus falls back on the principal to fulfil them. The principal may undertake the duties normally carried out by the agent, if the CIR agrees [s HD 4].

An assessment by the CIR is sufficient authority for the agent to pay the tax so assessed. Tax paid by an agent can be recovered from the principal or subtracted from money held by the agent that belongs or is payable to the principal. The agent can retain, from money belonging or payable to the principal, an amount sufficient to pay the principal’s tax liability. The CIR may set a new due date for an agent to pay a principal’s tax liability if:

(a) The agent is unable to pay the tax out of money the agent is holding on behalf of the principal (ie there is insufficient money);
(b) The agent has not disbursed any of the principal’s money after being assessed; and
(c) The enforcement of payment would cause the agent hardship [s HD 5].

If a person who is carrying on a business in New Zealand is sufficiently under the control of another person in business, whether in New Zealand or elsewhere, so that the relationship between them is effectively that of principal and agent, the CIR may treat the first business as the principal’s business carried on by the agent on behalf of the principal [s HD 6].
The rate of tax used to calculate an agent’s income tax liability is determined by reference to the taxable income of the principal. The amount of income tax payable is the amount determined by the amount of agency income as a proportion of the taxable income of the principal [s HD 7].

### 40.20 Persons deemed to be agents [Subpart HD]

A person may be treated as an agent of another person for income tax purposes in a variety of circumstances, as specified in subpart HD. An agency relationship arises in the following situations:

<table>
<thead>
<tr>
<th>Persons deemed to be agents</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>A person is treated as an agent if, while acting as a guardian or manager, they receive, control or dispose of income derived by a person who has a legal disability.</td>
<td>HD 9</td>
</tr>
<tr>
<td>A person is treated as an agent if, as mortgagee in possession of land or other property, they derive income on behalf or for the benefit of the mortgagor.</td>
<td>HD 10</td>
</tr>
<tr>
<td>A nominated company is treated as the agent of a consolidated group or an imputation group, and of each company that is a member of that group.</td>
<td>HD 11, FM 34(2), FN 6(3)</td>
</tr>
<tr>
<td>The trustee of a trust is treated as the agent of a beneficiary who derives beneficiary income or a taxable distribution from the trust.</td>
<td>HD 12(1), HC 32</td>
</tr>
<tr>
<td>The settlor of a trust (other than a charitable trust) is treated as the agent of the trustee for income tax payable by the trustee in a tax year if a settlor of the trust is resident in New Zealand in that tax year. This does not apply to income tax that the trustee is liable for as agent.</td>
<td>HD 12(2), HC 29</td>
</tr>
<tr>
<td>The trustee of a unit trust is treated as agent of the unit trust in relation to income derived by the unit trust.</td>
<td>HD 13</td>
</tr>
<tr>
<td>A company is treated as an agent of a debenture holder who derives income from the debenture [see 40.30].</td>
<td>HD 14</td>
</tr>
<tr>
<td>Directors and shareholders who have left a company with insufficient assets to meet a tax liability are treated as agents of the company [see 40.40].</td>
<td>HD 15</td>
</tr>
<tr>
<td>A person paying a premium to a non-resident general insurer, or the insured person, may be treated as agent of the insurer [see 40.50].</td>
<td>HD 16, HD 17</td>
</tr>
<tr>
<td>A person is treated as an agent if they receive, control or dispose of income derived by an absentee.</td>
<td>HD 19</td>
</tr>
<tr>
<td>A person is treated as an agent if they carry on in New Zealand, a business for an absentee, whether or not the income is received by the agent.</td>
<td>HD 20</td>
</tr>
<tr>
<td>A person is treated as the agent of an absentee in relation to the absentee’s partnership share of a partnership’s income under s HG 2 if:</td>
<td>HD 20B</td>
</tr>
<tr>
<td>(a) The person: (i) carries on a business in New Zealand in a partnership that is not a limited partnership, or (ii) is a general partner of a limited partnership that carries on a business in New Zealand; and</td>
<td></td>
</tr>
<tr>
<td>(b) The person carries on the business with an absentee or, as a general partner, is responsible for the management of a limited partnership in which a limited partner is an absentee.</td>
<td></td>
</tr>
<tr>
<td>A company incorporated in New Zealand is an agent of an absentee shareholder who receives a dividend from the company.</td>
<td>HD 21</td>
</tr>
<tr>
<td>A person (including a banking or other company) is treated as an agent if, in the course of their business activities, they hold money as a deposit and pay interest of more than $100 to an absentee on the money deposited.</td>
<td>HD 22</td>
</tr>
</tbody>
</table>
**Persons deemed to be agents**

A trustee of a group investment fund is treated as an agent in relation to a dividend paid to an absentee investor. HD 23

The master of ship is treated as an agent in relation to a business carried on with the ship, when it is owned by or under charter to an absentee. HD 24

A tenant, mortgagor or other person who remits money from New Zealand to an absentee landlord, mortgagee or creditor is treated as an agent if the amount is income of the absentee. This only applies if the CIR has notified the person that they are accountable as the absentee’s agent. HD 25

An employer is treated as an agent in relation to the employment income of a non-resident employee who has an income tax liability. HD 27(1)

A non-resident trader is treated as an agent in relation to the employment income of an employee in New Zealand. HD 27(2)

If a non-resident person derives a pension or annuity from the New Zealand Government or under an unregistered superannuation scheme established in New Zealand, any income tax payable on the pension or annuity must be withheld from the pension or annuity and paid to the CIR on the person’s behalf. HD 28

If a New Zealand resident agent of a non-resident principal is instrumental in arranging the purchase of goods from the principal and the goods are either in New Zealand or are to be imported into New Zealand, the: (a) principal is deemed to be carrying on a business in New Zealand, (b) agent is treated as the principal’s agent in relation to the income derived from the business; and (c) income from the business is treated as having a source in New Zealand. HD 29

The agent has no liability if the income would not be liable for income tax in the principal’s country of residence.

A shareholder who makes an election under s HA 5 that a company become a qualifying company is personally liable for their share of the company’s income tax liability [see 1160.30]. HA 8

For the purposes of the agency rules, an absentee means:

(a) A natural person who is for the time being out of New Zealand;

(b) A foreign company, unless it has a fixed and permanent place of business in New Zealand at which it carries on a business in its own name; or

(c) A foreign company when the CIR declares that it is an absentee by giving notice to the company, or its agent or representative in New Zealand [s HD 18(2)].

A person may also be an agent of a GST registered person in certain circumstances [see 580.89, 580.160].

**40.30 Company acting as agent of its debenture holders** [s HD 14]

A company is treated as an agent of a person if the company has issued a debenture and the person, as a debenture holder, derives income from the debenture. This applies whether or not the debenture is charged on the company’s property or the debenture holder is an absentee.

A company is not treated as an agent if the debenture is:

(a) A profit-related debenture or substituting debenture to which s FA 2 applies (ie a debenture which is treated as a share) [see 830.20], or a stapled debt security to which s FA 2B applies [see 830.40]; or

(b) Issued to a New Zealand resident and, before an assessment is made, the company provides the CIR with a certified list containing:
40.40  When director or shareholder is agent of company [s HD 15]

The directors and controlling shareholders of a company may be held personally liable to pay a company’s income tax (including civil penalties and interest) if:

(a) An arrangement has been entered into the effect of which is that the company cannot meet a current or future income tax liability;

(b) It is reasonable to conclude that this was done so deliberately; and

(c) It is reasonable to conclude that if a director of the company had made reasonable inquiries at the time of the arrangement, they could have anticipated that the income tax liability would be likely to arise.

All of the directors at the time the arrangement is entered into are treated as agents of the company, and they have joint and several liability for the company’s tax obligations. However, a director is not held liable if:

(a) They do not derive a benefit from the arrangement and, at the first reasonable opportunity after becoming aware of the arrangement, they formally record their dissent with the company and with the CIR; or

(b) They were not involved in the executive management of the company at the time the arrangement was entered into and had no knowledge of the arrangement or the aspects of it that invoke s HD 15.

A person who is a controlling shareholder or an interested shareholder when the arrangement is entered into is treated as an agent of the company in relation to its tax obligations, but the tax liability (and associated penalties and interest) is limited to the greater of:

(a) The market value of the person’s direct and indirect shareholding in the company at the time of the arrangement; and

(b) The value of the benefit the person derives from the arrangement.

The CIR may (subject only to the time bar) make an assessment of a company after it has gone into liquidation, in order to give effect to s HD 15. In making this assessment, the CIR must nominate one or more persons as having the tax obligations set out in the assessment. The nominated persons are treated as agents of the company in relation to any notification or objection procedure concerning the assessment.

The directors and shareholders of a company are not liable for the company’s income tax for any tax year in relation to which:

(a) The company has provided returns within the time allowed by s 37 of the TAA [see 1270.50] for providing returns for the tax year in which the company is liquidated; and

(b) The CIR has not issued a notice of assessment of the company for the tax year before the end of four years following the end of the tax year in which the company is liquidated.

No liability arises in relation to an arrangement if:

(a) The CIR is a party to it; and

(b) The tax obligation is no more than an amount of income tax that arises as a direct result of the performance of the arrangement, and that obligation has been met.
A “controlling shareholder” is a person whose voting or market value interest in a company at the time of the arrangement (including those of associated persons) is 50 per cent or more. If the person or associate is a company, the voting or market value interest is calculated as if they were not a company and as if ss YC 4 (look through rule) and s YC 6 (disregarding certain securities) did not apply.

An “interested shareholder” is a person who has a voting or market value interest in a company at the time of the arrangement and, because of the size of the benefit the person receives from the arrangement, it is reasonable to conclude that the person is a party to the arrangement.

40.50 Agents for non-resident general insurers [ss HD 16, HD 17]

When a non-resident general insurer derives income under s CR 3 [see 800.75], certain residents may be treated as agents liable to provide returns and pay income tax on behalf of the insurer. No other person has a tax obligation in relation to a non-resident general insurer to the extent that:

(a) The insurer provides the return and pays the income tax; or
(b) A person acting on behalf of the insurer, including a broker or other agent, provides the return and pays the income tax.

If a return is not provided or if the income tax liability is not met in full, the following persons are liable (in the order set out) to provide the return or pay the income tax:

(a) First, the person (including a broker or agent) who pays the premium to the insurer, or the person who provides a bank or building society with funds from which the premium is paid;
(b) Secondly, a person who pays the premium, whether or not through a broker or agent;
(c) Thirdly, the insured person.

If a premium is paid by a registered bank or a building society on behalf of a person to the insurer (or to some other person not carrying on a business in New Zealand through a fixed establishment in New Zealand), the person who provides the bank or building society with the funds from which the premium is paid is an agent of the insurer. The bank or building society is not an agent in these circumstances [s HD 16].

If the non-resident general insurer, or other person who receives a premium, is treated as resident in Switzerland for the purposes of the double tax agreement between New Zealand and Switzerland, a person who is an agent of the insurer under s HD 16 is required to disclose details of the payment of the premium to the CIR [s HD 17].

40.60 The Maori Trustee

See 950 MAORI AUTHORITIES for income that consists of rent, royalties, or interest derived by the Maori Trustee that is not also beneficiary income.

40.70 Tax agents [TAA, s 34B]

The CIR is required to compile and maintain a list of tax agents. From 19 December 2007, a person is eligible to be a tax agent if they are a practitioner carrying on a professional public practice, a person carrying on a business or occupation in which returns of income are prepared, or the Maori Trustee, and the person prepares the returns of income for 10 or more taxpayers.

A person wishing to become a tax agent must apply to Inland Revenue, stating they wish to be listed as a tax agent, and providing any other information required by Inland Revenue. If the applicant is not a natural person, the names of the following persons must be included in the application:

<table>
<thead>
<tr>
<th>Type of entity</th>
<th>Persons to be named</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate body that is not a closely-held company</td>
<td>Each person having the duties of tax manager, chief financial officer, chief executive officer or director.</td>
</tr>
<tr>
<td>Closely-held company</td>
<td>Each shareholder.</td>
</tr>
<tr>
<td>Partnership</td>
<td>Each partner.</td>
</tr>
<tr>
<td>Unincorporated body</td>
<td>Each member.</td>
</tr>
</tbody>
</table>

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Existing tax agents as at 19 December 2007 (the date s 34B of the TAA came into force) which are not natural persons and have not applied to be tax agents must provide the names as shown in the above table to Inland Revenue by 19 December 2008.

Inland Revenue may request further information from an applicant and obtain information about the applicant from other sources before deciding whether to list the applicant as a tax agent. Inland Revenue may list an applicant if satisfied that the applicant is entitled to make the application and that listing the applicant would not adversely affect the integrity of the tax system. Listing takes effect from the date of the notice advising the applicant of the CIR’s decision.

The Inland Revenue must refuse to list an applicant as a tax agent if the applicant is not entitled to make the application or if listing the applicant as a tax agent would adversely affect the integrity of the tax system. Inland Revenue may remove a person from the list of tax agents for the same reasons. However, before refusing to list an applicant or removing a person from the list, Inland Revenue must notify the person of the reasons for the proposed decision and consider any arguments put forward by the person. The person has 30 days from the date of the notice to put their arguments to the CIR, although the CIR can reduce this period if necessary to protect the integrity of the tax system. The CIR can also extend the 30-day period if this is considered appropriate in the circumstances.
Chapter 50

Armed Forces and Police

50.10 Members of armed forces
Any member of the armed forces (ie Army, Navy, or Air Force) absent from New Zealand in the service of the Government of New Zealand is a tax resident of New Zealand throughout their period of absence.

50.20 Operational areas pay
Allowances and any amount decided on by the ministerial committee (see below) are exempt income if they are received from the New Zealand Government by a member of the New Zealand Defence Force or Police force for a period of service in an operational area. The exemption does not extend to a regular force gratuity or any bonus or bounty for re-engagement in a regular force. An operational area is an area that the Minister of Defence has ordered the deployment of New Zealand Defence Force members for a specific mission authorised by the Government and which the Chief of Defence force delineates for that mission.
A special committee comprising the Prime Minister, Minister of Defence, Minister of Police, Minister of Finance and Minister of Foreign Affairs, determines whether an area is an “operational area”. This committee also prescribes rules for calculating the period of service in an operational area.
The extension of the exemption to members of the Police force applies from 18 March 2007.

50.30 Deferred military pay
Deferred military pay granted or paid under the Defence Act 1990 for military service in an active service area is exempt income.

50.40 Armed services or police annuity for disability
An annuity, pension, or allowance granted in New Zealand or elsewhere by any Government for any war or for a disability attributable to or aggravated by service in any Army, Navy, Air, or Police force, is exempt income. Any pension or allowance under the War Pensions Act 1954, other than a veteran’s pension is similarly exempt.
Chapter 60
Assessments

60.10 Assessments [TAA, ss 92, 92AA]
Most taxpayers self-assess their tax liability as part of meeting their return filing obligations.

“Assessment” means, according to the context:
(a) An assessment of tax made under a tax law by either a taxpayer or the CIR;
(b) An assessment of a net loss;
(c) An assessment of terminal tax or a refund;
(d) An assessment of a GST refund;
(e) An amendment of an assessment by the CIR [TAA, s 3(1)].

A taxpayer who is required to furnish a return of income for a tax year must make an assessment of their taxable income and income tax liability and, if applicable, their net loss, terminal tax, and refund due. A taxpayer assessment is made on the date on which the taxpayer’s return of income is received at an office of Inland Revenue.

The self-assessment rules do not apply for a tax year to a taxpayer:
(a) For whom a tax credit is allowed under subparts MA to MF and MZ [see 420 FAMILY ASSISTANCE]; or
(b) In respect of whom the CIR has made an assessment.

The nominated company for a consolidated group is treated as a taxpayer for the purposes of making an assessment for the group. A company that is part of a consolidated group must not make a separate assessment. The CIR must make an income tax assessment for a tax year for a taxpayer who has a tax credit under Part M (family assistance) [TAA, s 92AA].

The CIR may, before or after the passing of the annual taxing Act, assess the income tax of any taxpayer for a tax year at the basic rates specified in sch 1. Any such assessment is valid even if it is made before the passing of the annual taxing Act. If the annual rates of tax for a tax year differ from the basic rates on which
an assessment is made, the amount of the assessment is increased or decreased accordingly and the assessment has the same effect as if the amended amount were specified in the assessment [TAA, s 92A].

Despite the self-assessment rules, the CIR retains the power to make an amended assessment, for example following an audit of a taxpayer’s assessment [see 60.70]. A taxpayer cannot amend an assessment once made [see TIB vol 13:11 (November 2001) at 45-49].

Any assessment or determination made by the CIR that is made automatically by a computer or other electronic means in response to or as a result of information entered or held in the computer or other electronic medium is treated as an assessment or determination made by or under the delegated authority of the CIR [TAA, s 105].

In filing their GST returns, taxpayers are required to make an assessment of the amount of GST payable for the return period. The assessment is made on the date the GST return is received at an office of Inland Revenue. Any assessment made by the CIR will override a taxpayer self-assessment [TAA, s 92B].

The Court of Appeal reviewed the meaning of an assessment. It is the quantification by the CIR of the statutorily imposed liability of a particular taxpayer to tax for the year in question. The making of an assessment, including an amended assessment, requires the exercise of judgment on the part of the CIR in quantifying that liability on the information then in the possession of the CIR. It involves the ascertainment of the taxable income and of the resulting tax liability: Commissioner of Inland Revenue v Canterbury Frozen Meat Co Ltd (1994) 16 NZTC 11,150 (CA).

In Commissioner of Inland Revenue v New Zealand Wool Board (1999) 19 NZTC 15,476 (CA), the taxpayer challenged the validity of an amended assessment made by the CIR shortly before the time bar expired. In the High Court, it was held that the assessment was invalid and unenforceable on the grounds that:

(a) The pre-assessment inquiry was inadequate and the CIR did not make an honest judgment when reassessing the Board;
(b) The Board had a legitimate expectation of being consulted by the CIR before the assessment was issued;
(c) The reassessment was motivated by the improper purpose of countering criticism of Inland Revenue in Parliament and the Winebox Inquiry.

However, the Court of Appeal overturned this decision and held that:

(a) The evidence did not establish that the CIR did not exercise an honest judgment in making the assessment. At the date the assessment was made, it could not be said that the CIR had insufficient information on which to make an honest judgment on tax liability, or that it acted arbitrarily or in disregard of the law or facts known to it. In reaching this conclusion, the Court of Appeal relied on the meaning of assessment as expounded in Commissioner of Inland Revenue v Canterbury Frozen Meat Co Ltd (1994) 16 NZTC 11,150 (CA) (see above).

(b) Any scope for invoking legitimate expectation of being consulted by the CIR is necessarily limited by the scheme and purpose of the income tax legislation. Legitimate expectation cannot frustrate an honest appraisal by the CIR of the taxpayer’s income tax liability by means of an assessment of that liability. Faced with the time bar, if the CIR concludes that there is a proper basis for making an assessment the CIR is required to make an assessment. It is impossible to read into the legislation an obligation on the CIR to set a timetable that would always allow time for consulting before making an assessment within the time bar.

(c) Even if the CIR is influenced by extraneous factors in considering the taxpayer’s position, the CIR may nevertheless end by making a proper assessment by altering or adding to an existing assessment in order to ensure its correctness. It is the CIR’s judgment that counts — given the finding that the assessment was an honest exercise by the CIR of its judgment as to the tax liability of the Board, there is simply no room for denying its validity.
The CIR performs a statutory duty imposed on it in imperative and unconditional terms which is solely susceptible to objection under statutory procedures: *Commissioner of Inland Revenue v Lemmington Holdings Ltd* [1982] 1 NZLR 517, (1982) 5 NZTC 61,268 (CA).

The CIR’s functions are directed by statute to the quantification of liability for tax which is imposed by the statute itself. They are not a matter of balancing management and collection responsibility as in England. The CIR does not have a general dispensing power and cannot be estopped by past conduct from performing the statutory obligations in making assessments reflecting the present judgment as to that statutorily imposed liability: *North Island Wholesale Groceries Ltd v Hewin* (1982) 5 NZTC 61,289 (CA).

A notice of assessment mistakenly generated by the Inland Revenue computer is not necessarily an assessment: *Paul Finance Ltd v Commissioner of Inland Revenue* (1994) 16 NZTC 11,257 (HC).

### 60.20 Notices of assessment to be given to taxpayer [TAA, s 111]

The CIR must give the taxpayer a notice of assessment as soon as conveniently possible after making an assessment. However, if the CIR omits to provide the taxpayer with a notice of assessment, this does not invalidate or affect the operation of the assessment. If requested to do so, the CIR must give a notice of assessment to a taxpayer who accepts an income statement [see 1270.75] as correct.

It is not necessary for the notice to show any particulars other than the tax payable or refund due, where:

(a) The taxpayer has calculated on the return form the taxable income or the tax payable. The form contains provision for self-calculation by the taxpayer of the tax payable or refund due;

(b) The assessment is a default assessment;

(c) The assessment is made after the taxpayer has failed to meet their obligations in relation to an income statement under s 80F of the TAA;

(d) An assessment is deemed to be made under the income statement rules; or

(e) A separate statement is given to the taxpayer setting out the taxable income and tax payable.

If the CIR makes an assessment in relation to goods sold in satisfaction of a debt (under s 5(2) of the GSTA 1985), the CIR must send a copy of the assessment notice to the person who is not assessed (ie either the person whose goods were sold or the person who sells them).

### 60.30 Illustration of an individual assessment

Examples are based on income tax rates for the 2011-12 income year.

**Example 1:**

Laura derived the following income during the tax year:

<table>
<thead>
<tr>
<th>Income</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary (gross)</td>
<td>$62,954.00</td>
</tr>
<tr>
<td>Interest (gross)</td>
<td>$1,158.00</td>
</tr>
<tr>
<td>Dividends (gross, fully imputed)</td>
<td>$2,874.00</td>
</tr>
<tr>
<td>Income from self employment (net)</td>
<td>$13,665.00</td>
</tr>
</tbody>
</table>

Laura’s summary of earnings from Inland Revenue shows that PAYE of $11,895.14 (exclusive of the earner premium) was deducted from her salary.

Laura holds shareholder dividend statements showing that imputation credits of $804.72 were attached to the dividends and RWT of $143.70 was deducted.

She holds interest RWT deduction certificates for $382.14.

She made provisional tax payments totalling $4,236 for the tax year.

**Assessment:**

<table>
<thead>
<tr>
<th>Income</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary</td>
<td>$62,954.00</td>
</tr>
<tr>
<td>Interest</td>
<td>$1,158.00</td>
</tr>
<tr>
<td>Dividends</td>
<td>$2,874.00</td>
</tr>
<tr>
<td>Income from self employment</td>
<td>$13,665.00</td>
</tr>
</tbody>
</table>
### Assessments

- **Taxable income**: $80,651.00
- **Income tax on $80,651**: $17,534.83
- **Less tax credits**:
  - Imputation credits: $804.72
  - PAYE: $11,895.14
  - RWT – dividend: $143.70
  - RWT – interest: $382.14
  - **Total**: $13,225.70
- **Residual income tax**: $4,309.13
- **Less provisional tax paid**: $4,236.00
- **Terminal tax**: $73.13

Laura will be required to pay ACC levies on her income from self-employment [see 20 ACCIDENT COMPENSATION].

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### Example 2:
Nigel derived the following income during the tax year:
- **Wages (gross)**: $21,348.00
- **Interest (gross)**: $207.00
- **Payment for supply of whitebait (gross)**: $2,425.00

Nigel’s summary of earnings from Inland Revenue shows that PAYE of $2,750.02 was deducted from his wages. He holds a RWT certificate for $36.22 in respect of the interest received. His summary of earnings shows that tax of $606.25 was deducted from the payment for whitebait.

- **Wages (gross)**: $21,348.00
- **Interest (gross)**: $207.00
- **Payment for supply of whitebait**: $2,425.00
- **Taxable income**: $23,980.00
- **Income tax on $23,980**: $3,216.50
- **Less tax credits**:
  - PAYE: $2,750.02
  - RWT: $36.22
  - **Tax deducted from payment for whitebait**: $606.25
  - **Total**: $3,392.49
- **Refund due**: $175.99

Nigel will be required to pay ACC levies on his income from the supply of whitebait [see 20 ACCIDENT COMPENSATION]. Nigel may also be entitled to family assistance if he has dependent children [see 420 FAMILY ASSISTANCE]. Nigel does not qualify for the independent earner tax credit because his net income is less than $24,000.

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### 60.40 Default assessments [TAA, s 106]

If any person defaults in furnishing a return, or if the CIR is not satisfied with the return furnished, the CIR has the power to make an assessment which, in its opinion, is the tax that ought to be levied, and the taxpayer is liable to pay the tax assessed, unless he or she can establish that the assessment is excessive, or is not chargeable. This is commonly referred to as a default assessment.

If the CIR considers that any of the particulars in an income statement [see 1270.75], are incorrect, it can issue an assessment of the amount of tax the CIR considers ought to be imposed. A default assessment will not be issued if the taxpayer informs Inland Revenue that there is an error in the income statement and provides the information necessary to correct it by the due dates prescribed in s 80F of the TAA. The tax assessed...
under a default assessment is payable unless the person disputes the assessment and complies with the requirements of s 89D of the TAA [see 260.20].

A taxpayer cannot dispute a default assessment unless the taxpayer has issued a NOPA [see 260.20] and filed the missing return within the two-month response period: *Allen v Commissioner of Inland Revenue* (2005) 22 NZTC 19,473 (CA).

The CIR may make a default assessment of the GST payable by a person for a return period if the person:

(a) Fails to provide a GST return for the period when required to do so; or
(b) Provides a GST return that the CIR is not satisfied with.

A person who is assessed in this way must pay the GST assessed unless they establish in proceedings challenging the assessment that it is excessive, or that the person is not chargeable with GST.

Taxpayers who were in partnership as milk vendors were issued with amended assessments for the income years from 1974-1980. Their objection was allowed. The CIR’s assessments were to a large extent arbitrary and without foundation and the taxpayer satisfied the onus of proof by showing that the amended assessments were wrong: *TRA Case F144* (1984) 6 NZTC 60,270.

The manager of Inland Revenue’s Adjudication Unit has delegated authority under s 7 of the TAA to make assessments. An Adjudication Unit report may contain an assessment of income tax or GST, and the original or a copy of that report is admissible as evidence in court: *Marshall v Commissioner of Inland Revenue* (2008) 23 NZTC 21,876 (HC).

### 60.50 Special returns and assessments [TAA, s 44]

The CIR has the discretion to require certain categories of person (see below) to make a special return for specified transactions, or for a specified period, and to assess the person for income tax accordingly. If the person defaults in making the special return, or the CIR is not satisfied with the return, the CIR may assess the person on the amount the CIR thinks reasonable. The CIR must give the person notice of the special assessment.

Persons from whom the CIR can require special returns are:

(a) Agents;
(b) Non-resident traders;
(c) Persons who the CIR believes are about to leave New Zealand, or are about to cease carrying on business in New Zealand;
(d) Persons who have ceased to carry on business in New Zealand or to derive income;
(e) Executors or administrators, in respect of income derived by a deceased taxpayer during his/her lifetime;
(f) Bankrupt persons and companies in liquidation.

A person may challenge a special assessment under Part 8A of the TAA. Tax assessed under a special assessment is payable on demand, and is recoverable in the same way as for tax assessed under an ordinary assessment [see 1100 PAYMENT AND COLLECTION OF TAX]. The making of a special assessment does not preclude a subsequent assessment being made for the tax year in the normal way. However, any tax paid under the special assessment is credited against the subsequent assessment.

### 60.60 Net asset accretion assessments [TAA, s 106]

The CIR may issue assessments on a net assets basis. These are usually the result of an examination of the taxpayer’s records by an inspecting officer. During the examination, the inspector endeavours to ascertain the taxpayer’s correct income for taxation purposes from the books and records, but if it is found these are incomplete or unsatisfactory, the inspector may adopt the net assets method of arriving at the income. Under this method the private and business assets and liabilities of the taxpayer at the beginning and end of each tax year are ascertained and compared. From the increase each year are deducted non-taxable receipts (eg capital accretions, gifts, legacies, and exempt income). An addition is made of any non-deductible expenditure.
Assessments

of loss (eg loss on trade-in of private motor car), together with an estimate of the living expenses of the taxpayer and the taxpayer’s family.

Example:

<table>
<thead>
<tr>
<th>Year Ended</th>
<th>31/3/X1</th>
<th>31/3/X2</th>
<th>31/3/X3</th>
<th>31/3/X4</th>
<th>31/3/X5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank balance</td>
<td>$2,000</td>
<td>$4,000</td>
<td>$6,000</td>
<td>$8,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>PostBank balance</td>
<td>7,000</td>
<td>$16,000</td>
<td>$11,000</td>
<td>$14,000</td>
<td>$18,000</td>
</tr>
<tr>
<td>Savings bank balance</td>
<td>8,000</td>
<td>$4,000</td>
<td>$5,000</td>
<td>$10,000</td>
<td>$8,000</td>
</tr>
<tr>
<td>Trading stock</td>
<td>$120,500</td>
<td>$121,200</td>
<td>$119,600</td>
<td>$122,400</td>
<td>$126,000</td>
</tr>
<tr>
<td>House</td>
<td>$280,000</td>
<td>$280,000</td>
<td>$280,000</td>
<td>$280,000</td>
<td>$280,000</td>
</tr>
<tr>
<td>Motor car</td>
<td>19,000</td>
<td>nil</td>
<td>$20,000</td>
<td>$20,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Spouse’s PostBank</td>
<td>400</td>
<td>$1,200</td>
<td>$2,000</td>
<td>$2,400</td>
<td>$3,000</td>
</tr>
<tr>
<td>Child’s savings bank</td>
<td>200</td>
<td>$300</td>
<td>$400</td>
<td>$500</td>
<td>$800</td>
</tr>
<tr>
<td>Furniture</td>
<td>$20,000</td>
<td>$20,000</td>
<td>$20,000</td>
<td>$20,000</td>
<td>$20,000</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>$457,100</td>
<td>$446,700</td>
<td>$464,000</td>
<td>$477,300</td>
<td>$485,800</td>
</tr>
<tr>
<td>Mortgage</td>
<td>$140,000</td>
<td>$137,500</td>
<td>$135,000</td>
<td>$130,000</td>
<td>$125,000</td>
</tr>
<tr>
<td>Sundry creditors</td>
<td>$18,500</td>
<td>$12,900</td>
<td>$17,400</td>
<td>$23,500</td>
<td>$22,000</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>$158,500</td>
<td>$150,400</td>
<td>$152,400</td>
<td>$153,500</td>
<td>$147,000</td>
</tr>
<tr>
<td><strong>Net worth</strong></td>
<td>$298,600</td>
<td>$296,300</td>
<td>$311,600</td>
<td>$323,800</td>
<td>$338,800</td>
</tr>
<tr>
<td>Less previous year</td>
<td>nil</td>
<td>$298,600</td>
<td>$296,300</td>
<td>$311,600</td>
<td>$323,800</td>
</tr>
<tr>
<td>Add capital loss on sale of car</td>
<td>$10,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deduct legacy received</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$4,000</td>
</tr>
<tr>
<td>Add taxes paid during year</td>
<td>$7,700</td>
<td>$11,300</td>
<td>$12,200</td>
<td>$15,000</td>
<td></td>
</tr>
<tr>
<td>Add life premiums paid</td>
<td>$2,900</td>
<td>$1,850</td>
<td>$1,750</td>
<td>$1,900</td>
<td></td>
</tr>
<tr>
<td>Add estimated living expenses</td>
<td>$9,500</td>
<td>$9,500</td>
<td>$9,500</td>
<td>$9,500</td>
<td></td>
</tr>
<tr>
<td><strong>Total estimated income</strong></td>
<td>$29,600</td>
<td>$32,650</td>
<td>$33,950</td>
<td>$37,400</td>
<td></td>
</tr>
<tr>
<td><strong>Allocated to:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxpayer</td>
<td>$29,574</td>
<td>$32,603</td>
<td>$33,902</td>
<td>$37,330</td>
<td></td>
</tr>
<tr>
<td>Spouse’s Postbank interest</td>
<td>$20</td>
<td>$40</td>
<td>$40</td>
<td>$60</td>
<td></td>
</tr>
<tr>
<td>Child’s savings bank interest</td>
<td>$6</td>
<td>$7</td>
<td>$8</td>
<td>$10</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$29,600</td>
<td>$32,650</td>
<td>$33,950</td>
<td>$37,400</td>
<td></td>
</tr>
</tbody>
</table>

Notes:

(1) The motor car is used exclusively for private purposes. Consequently, the loss on sale is not deductible and has been added back to arrive at the income for the 20X1-X2 year.

(2) The legacy, being a capital receipt, has been deducted in arriving at the income for the 20X2-X3 year.

(3) In estimating living expenses the inspector has regard to the taxpayer’s mode of living from such evidence as is available.

(4) The PostBank and Savings Bank interest of the wife and child is included in the balance of the assets each year, and the interest applicable must be deducted in arriving at the taxpayer’s income.
While the assets accretion method has no express statutory authority, it has received recognition and approval by New Zealand Courts, and the following principles arise from the case of Glausiuss v Commissioner of Inland Revenue (1970) 1 ATR 588 (SC) and others:

(a) The assets accretion method is one which the CIR is entitled to apply in estimating the net income of a taxpayer for the purpose of assessing tax.

(b) Provided the CIR employs this method bona fide for this purpose, the assessment must stand save only so far as the taxpayer establishes that the amount is excessive: Babington v Commissioner of Inland Revenue [1957] NZLR 861 (SC).

(c) It is not sufficient for the taxpayer to establish that the income for any particular year, ascertained by this method, is not correct. The taxpayer must also show by how much it is wrong: Babington v Commissioner of Inland Revenue [1957] NZLR 861 (SC) and Commissioner of Taxes (New Zealand) v McCoard [1952] NZLR 263 (SC).

(d) The CIR may properly spread the value of an asset representing income derived by the taxpayer during the period covered by the assets accretion statement equally over each of those years if there is no satisfactory evidence to show the year or years in which it was in fact derived. If it does, the onus is on the taxpayer to prove in what year or years it was derived: Trautwein v Federal Commissioner of Taxation (1936) 56 CLR 63 (HCA).

(e) Spreading should be adopted in such a way as to produce a realistic result, that is, in accordance with the proved facts. The method is not sufficiently accurate for any particular year to afford proof beyond reasonable doubt that a taxpayer’s return of income for that year is wilfully false, on a prosecution: Hall v Commissioner of Inland Revenue [1965] NZLR 184 (SC).

It is not necessary that the CIR’s estimate of living expenses be arithmetically exact. Absence of specificity does not indicate arbitrariness. The CIR’s judgment is entitled to be exercised as a matter of assumption in the sense of judgment based on a knowledge of facts, aided by a vast experience of common affairs in the New Zealand household: Sherwood v Commissioner of Inland Revenue (1987) 9 NZTC 6,059 (HC).

Failure to take account of cash on hand in using the method will make the assessment fundamentally defective: Gregoriadis v Regional Controller (1977) 3 NZTC 61,190 (SC).

Where a defence of the classic assets accretion method is made, there should be some verification of the objector’s evidence. This would apply to cash hoards alleged to exist at the beginning of the investigation period and to liabilities said to exist at the end of the period: TRA Case N21 (1991) 15 TRNZ 758.

The CIR used the add-back method to carry out an investigation, two amounts were held to be capital and, therefore, not assessable on the balance of probabilities. The direct and unshaken evidence of the taxpayer outweighed the slender case on which the CIR based the assessment: Singapore Restaurant Ltd v Commissioner of Inland Revenue (1990) 12 NZTC 7,308, (1990) 15 TRNZ 241 (HC).

The TRA confirmed an assessment using the assets accretion method when the taxpayer failed to produce evidence at the TRA hearing to discharge the onus of proof: TRA Case R4 (1994) 16 NZTC 6,025.

60.70 Amendments to assessments [TAA, s 113]

The CIR may from time to time, and at any time, amend an assessment in order to ensure its correctness, even if the tax already assessed has been paid. The CIR may not amend an assessment if the disputes process has not been completed [see 260.60]. If an amendment imposes a fresh liability or increases an existing liability, the CIR must give notice of it to the taxpayer.

The taxpayer is entitled to challenge the amended assessment in the ordinary manner within the statutory period. Inland Revenue’s practice for exercising the CIR’s discretion under s 113 of the TAA is explained in 60.120.
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60.80

Where the CIR has examined returns and concluded that no tax was payable, it amounts to an assessment for the purposes of applying the four-year time limitation [see 60.80] for reassessment: Lloyds Bank Export Finance Ltd v Commissioner of Inland Revenue (1988) 10 NZTC 5,088 (HC).

The words “at any time” have been considered in Commissioner of Inland Revenue v McNab (1984) 6 NZTC 61,703 (SC) in an appeal to the High Court against an earlier TRA decision. The taxpayer’s travel expenses had originally been allowed by the CIR as a deduction but it later advised the taxpayer that no deduction was available and issued amended assessments. The TRA upheld the objector’s view that the CIR’s power to alter assessments did not apply to assessments fixed under the previous s 31(1) [TAA, s 127(1)].

The CIR contended that the previous s 23 entitled it to issue amended assessments at any time and it could not be stopped from issuing assessments by any previous decision made. The appeal was allowed and it was held that the CIR is obliged to carry out the duty of assessing tax and cannot be estopped from exercising its statutory assessing power. The CIR, when issuing assessments, exercises an administrative function and the doctrine of res judicata cannot apply. The CIR’s power of amendment is only lost in relation to income which has been determined by the Courts.

Whether the CIR can rely on new grounds at the hearing was considered in Commissioner of Inland Revenue v FH Farnsworth Ltd (1984) 6 NZTC 61,770 (CA). The taxpayer was assessed by the CIR under the previous s 129 and at the Court hearing the CIR advanced the previous s 74 in support of its original assessment. The Court of Appeal refused to allow the CIR to rely on s 74 as at the hearing the CIR is tied to the basis on which he arrived at the assessment. The Court distinguished between cases where the CIR amplifies the grounds on which it originally relied in making the assessment and cases where it advances new contentions to support the application of a statutory principle. The CIR cannot, after the tax year limitation has expired, advance a different ground for assessment. Section 125 of the TAA does not allow the taxpayer to respond if the CIR is free to adopt a fresh basis for assessing an item under objection.

This decision must be contrasted with the decision in Hornby Leaseholds Ltd v Commissioner of Inland Revenue (1984) 6 NZTC 61,736 (HC), where the words “fresh liability” and “existing liability” were considered by the High Court. In this case, the CIR originally issued assessments under the previous s 88AA(1)(b). Subsequently, prior to the hearing it issued an amended assessment relying on all provisions of s 88AA. The TRA decided the amended assessment was invalid but on appeal the Court held the CIR was entitled to issue an amended assessment including additional grounds without amending the amount assessed.

The manager of Inland Revenue’s Adjudication Unit has delegated authority under s 7 of the TAA to make assessments. An Adjudication Unit report may contain an assessment of income tax or GST, and the original or a copy of that report is admissible as evidence in court: Marshall v Commissioner of Inland Revenue (2008) 23 NZTC 21,876 (HC).

60.80 Time bar for reassessing income tax [TAA, s 108]

The CIR may not amend an assessment so as to increase the amount of income tax assessed if:

(a) A taxpayer furnishes an income tax return and an assessment has been made; and

(b) Four years have passed from the end of the tax year in which the tax return was filed.

The time bar does not apply if the CIR considers that a tax return provided by a taxpayer:

(a) Is fraudulent or wilfully misleading; or

(b) Does not mention income which is of a particular nature or was derived from a particular source, and for which a tax return is required to be provided.

In these circumstances, the CIR may amend the assessment at any time so as to increase the amount.

If a taxpayer successfully challenges a CIR’s refusal to accept a late notice, etc, under s 89K(4) [see 260.50], the four year period referred to above is extended by the number of days in the period that:

(a) Starts on the day of the refusal, and

(b) Ends on the day the challenge is finally judged successful by the relevant TRA or Court, or the day on which the CIR concedes.
The CIR must not issue an income statement [see 1270.75] if four years have passed since the end of the tax year that follows the tax year to which the income statement would apply, unless the return is fraudulent, etc (as set out above), or the taxpayer has agreed to extend the time bar under s 108B of the TAA [see 60.100]. Section 108 of the TAA overrides every other provision, whether in the TAA or any other Act, that limits the CIR’s right to amend assessments.

When the taxpayer has a non-standard balance date, the four-year statutory period commences on the 1 April next following the date on which the taxpayer files their return [see TIB vol 14:11 (November 2002) at 94].

Example:
A taxpayer with a 30 September balance date files their 20X1-X2 income year (the year ending 30 September 19X2) return on 15 January 20X3. The four-year statutory period begins on 1 April 20X3. Increases to the assessment are time barred after 31 March 20X7 unless the return was fraudulent, etc.

In TRA Case F146 (1984) 6 NZTC 60,283, the taxpayer was a drug dealer who had filed returns for the 1970-1979 income years. Subsequently, an amended return for 1976 was filed which included income from secret commissions. Following an investigation by the CIR, amended assessments for the years 1970-1979 were issued. The taxpayer’s objection was allowed in part. It was held that the CIR had reasonable grounds for believing that the taxpayer’s returns for the years 1970-1974 were fraudulent or wilfully misleading.

An appeal may be made from the exercise by the CIR of its discretion on the ground that the CIR was not justified in reopening assessments beyond the four-year period. The objection is referred to the TRA or in certain circumstances direct to the High Court in which case the TRA (or the High Court) must substitute its own opinion for that of the CIR, and not merely satisfy itself whether there was no ground, or insufficient ground, for the CIR’s opinion: Legarth v Commissioner of Inland Revenue [1967] NZLR 312 (SC). See also the discussion of Commissioner of Inland Revenue v New Zealand Wool Board (1999) 19 NZTC 15,476 (CA) at 60.10.

Where a taxpayer omitted from the return all mention of income from a particular source (eg interest or rent for any year), the CIR would automatically have the right to reopen the assessment for the relevant year or years at any time without the necessity of applying its mind to the question of whether the particular return was fraudulent or wilfully misleading. This aspect did not concern the Court in the above case.

In Cross & Goulding v Commissioner of Inland Revenue [1987] 1 NZLR 498 (1987) 9 NZTC 6,101 (CA), 1974 income year accounts attached to filed returns clearly showed substantial sums had arisen from a sizeable development, and expenses had been incurred. It was held that this was sufficient to draw the item to the CIR’s attention. The returns did not omit all mention of income in the form of gains from land sales. Thus, the CIR was prevented from relying on the former s 25(2) to reassess the 1974 income year, the statutory period having expired.

A notice of assessment sent to a taxpayer in error is not a valid assessment for the purposes of determining whether the four-year period in s 108(1) of the TAA has been exceeded: Golden Bay Cement Co Ltd v Commissioner of Inland Revenue (1996) 17 NZTC 12,580 (CA).

The “BASF principle” states that where, in relation to an assessment, a case stated has been filed on a particular point, the CIR is barred from amending the original assessment so far as that point is concerned. The CIR is not prevented from issuing amended assessments in relation to issues not covered in the case stated: BASF New Zealand Ltd v Inland Revenue (1995) 17 NZTC 12,136 (CA); Commissioner of Inland Revenue v Dandelion Investments Ltd (1999) 19 NZTC 15,317 (HC); Dandelion Investments Ltd v Commissioner of Inland Revenue (2000) 19 NZTC 15,585 (CA).

Despite the time bar, the CIR may not amend an assessment so as to increase an amount of research and development tax credit under s LH 2 if:
(a) A taxpayer furnishes an income tax return for the 2008-2009 or a later tax year; and
(b) Two years have passed from the latest date to provide a return of income for the relevant tax year. (For a member of an internal software development group to which s 68E of the TAA applies, the latest date means the latest date for any member of the group); and
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(c) The taxpayer:
   (i) Has not issued a NOPA to the CIR for an amount of research and development tax credit for the relevant tax year within the relevant response period; and
   (ii) Has not asked for an assessment to be amended under s 113 of the TAA, having provided a detailed research and development statement under s 68D or 68E of the TAA, as applicable, within the time limit referred to in (b).

60.90 Time bar for reassessing GST [TAA, s 108A]

If a taxpayer provides a return for a GST period and an assessment has been made, the CIR may not amend the assessment to increase the amount of GST assessed if four years have passed from the end of the GST period in which the GST return was provided.

Example:
Traders Ltd filed its GST return for the two months ended 31 March 20X1 on 26 April 20X1. The return contains an unintended error that understates the amount of GST payable. The GST return was filed during the GST period ended 31 May 20X1. Inland Revenue cannot amend the assessment after 31 May 20X5.

However, if the CIR considers that a taxpayer has knowingly or fraudulently failed to disclose all the material facts that are necessary for determining the amount of GST payable for a return period, the CIR may at any time amend an assessment to increase the amount of GST assessed.

If a taxpayer successfully challenges a CIR’s refusal to accept a late notice, etc, under s 89K(4) [see 260.50], the four year period referred to above is extended by the number of days in the period that:
(a) Starts on the day of the refusal, and
(b) Ends on the day the challenge is finally judged successful by the relevant TRA or Court, or the day on which the CIR concedes.

60.100 Extension of time bars [TAA, s 108B]

The time bars (referred to below) may be delayed by waiver for up to 12 months, by written agreement between the CIR and the taxpayer. The taxpayer may extend the time bar by a further six months by giving written notice to the CIR.

A waiver does not affect the application of a time bar to an assessment by the CIR on a ground that was not identified before the original time bar would have applied.

A waiver must be in the prescribed form, and must be signed and delivered to the CIR before the expiry of the relevant four-year period.

The time bars that may be extended by waiver are those occurring under:
(a) Section 25 of the ITA 1976;
(b) Section 107A of the TAA;
(c) Section 108 of the TAA (as it applied before being amended by the Tax Administration Amendment Act (No 2) 1996);
(d) Section 108 of the TAA (as amended by the Tax Administration Amendment Act (No 2) 1996);
(e) Former s 31 of the GSTA 1985 (as that section applied on 30 September 1996);
(f) Section 108A(1) of the TAA.

In Commissioner of Inland Revenue v Vela Fishing Ltd (2001) 20 NZTC 17,242 (CA), the Court of Appeal ruled that a waiver of time bar signed by the taxpayer was valid. The High Court had ruled that the waiver was invalid because when the taxpayer filed its 1991 tax return (19 July 1993) the applicable provision (s 25 of the ITA 1976) provided no power of waiver and, following the passing of the ITA 1994 and TAA 1994, s 25 was saved by s YB 5(2) of the ITA 1994: Vela Fishing Ltd v Commissioner of Inland Revenue [2001] 1 NZLR 437, (2000) 19 NZTC 15,885 (HC). The Court of Appeal held that the time bar was valid because
the corresponding provision elements of s 227(4) of the TAA 1994 applied to relate the new s 108 of the TAA 1994, and linked s 108B of the TAA 1994 to s 25 of the ITA 1976.

60.110 Reopening assessments when accounts information form (IR10) used

The CIR’s policy on the reopening of assessments when returns were filed with an IR10 rather than with financial statements is stated in TIB vol 10:3 (March 1998) at 40.

The IR10 is an integral part of Inland Revenue’s E-File (electronic filing of returns) system. Inland Revenue use it to provide information to the Statistics Department and to build up data for audit case selection. Accountants and taxpayers who file returns manually may either send in an IR10 or a set of financial statements with tax returns. Inland Revenue encourages accountants to use both the E-File and the IR10 systems.

The IR10 has limited disclosure facilities. This might cause difficulties in discrepancies and allow reassessments to work against the taxpayer. If such a discrepancy is an item that is recorded in the financial statements (obtained at the time of audit or investigation), but which did not need to be recorded on the IR10, s 108(2) of the TAA could be used to reopen the statute-barred assessment with the argument that full disclosure was not given in the return for that particular item. The problem does not exist when the financial statements are filed with the tax return. The CIR applies the following policy when auditing or investigating back year returns filed with an IR10:

(a) If it is revealed that an item is incorrectly recorded in the financial statements, which is deemed to be either assessable income or non-deductible expenditure, but which did not have to be so recorded on the IR10, then:
   (i) If no conclusive evidence is held to prove a fraudulent or wilful misleading by the taxpayer, a statute-barred back year assessment is not reopened; or
   (ii) If there is conclusive evidence that a taxpayer intended to fraudulently or wilfully mislead, then a statute-barred assessment is reopened.

(b) If it is revealed that there is an omission of income, then:
   (i) If the omission is because disclosure was not required on the IR10 (but the income was recorded in the financial statements which were not filed with the CIR) then this is not a reason for reopening a statute-barred assessment; or
   (ii) If the income was omitted from the financial statements then a statute-barred assessment may be reopened.

(c) Persons who are parties to a financial arrangement which must be disclosed to the CIR are required to file a Disclosure Return (IR4A) or a Property Disclosure Return (IR4T) unless there is a reporting exemption for the arrangement. If the profit on an item has been disclosed and there has not been an omission of all mention of the item, this is not reason to open the assessment, whether or not the profit recorded in the disclosure return is recorded in the financial statement.

60.120 Taxpayer requests to amend assessments [TAA, ss 108, 113; s RM 2]

When a taxpayer files a tax return, and then later discovers that there is an unintended error in the return such as a calculation error or a figure incorrectly transcribed, the taxpayer may ask Inland Revenue to correct that error. Under s 113 of the TAA [see 60.70] the CIR has the discretion to alter an assessment to ensure its correctness. This applies to income tax and GST, but not to gift duty or gaming duties.

Standard practice statement SPS 07/03 (which applies from 17 May 2007) [see TIB vol 19:5 (June 2007) at 8-15] explains how the CIR will exercise the discretion under s 113 of the TAA to amend an assessment to ensure its correctness.

A request by a taxpayer or their agent to amend an assessment must be given in writing and should include the following information:
(a) The tax types and periods containing errors;
(b) The amount of tax in error;
(c) A description of the errors, including the background circumstances and the reason for their occurrence;
(d) The nature of the errors, including any relevant tax laws;
(e) How and why the errors were identified;
(f) Details of any incorrect advice given directly to the taxpayer by Inland Revenue and how the taxpayer relied on that advice;
(g) The action required to correct the errors; and
(h) All relevant documents and records supporting the amendment request.

Strictly speaking, a taxpayer cannot correct an error in a filed tax return simply by submitting an amended return. However, a copy of a tax return showing the amended calculations can be used as a supporting document for an application under s 113 of the TAA.

The CIR has no legal obligation to consider all amendment requests or to amend an assessment even if an error is identified. When considering an amendment request, the CIR must take into account all relevant factors and merits on a case-by-case basis, including:

(a) The reasons for the errors;
(b) The amount of time which has passed since the errors were made;
(c) The resources required or difficulty faced by the CIR in verifying the errors; and
(d) The relative importance or amount of the amendments sought.

Except for the application of the statutory time limitations, the length of time that has passed since the errors were made will not be a determining factor for exercising the discretion in relation to arithmetical or transposition errors that are clear and result in incorrect tax positions.

The CIR will normally amend an assessment if the taxpayer can show that the original tax return incorrectly recorded the tax position they intended to take (eg a transposition error). However, the CIR will not exercise the discretion under s 113 of the TAA if the request for amendment involves a matter of regretted choice (eg a taxpayer wants to change the way they have calculated depreciation or valued their trading stock).

The CIR will only amend an assessment to ensure its correctness if:

(a) The amendment request is clear (ie the errors are identified clearly), both factually and legally;
(b) The taxpayer has provided all relevant information;
(c) The CIR has verified the errors as genuine;
(d) The amendments are to be made within the relevant time limits [TAA, s 108; s RM 2; GSTA, s 45]; and
(e) None of the other limitations apply (see below).

When amending assessments, the CIR will ensure that all consequential amendments to other tax types and periods are also made. If the CIR is already investigating the tax type and period to which the amendment request relates, the amendment request will be considered as part of the overall investigation. The CIR will not (assuming the CIR agrees with the requested change) amend an assessment to reflect the amendment request before finalising the position in relation to the other issues arising from the investigation.

Where a taxpayer requests an amendment to an assessment to reflect a court decision that affects them or another taxpayer, the CIR will consider the following factors in deciding whether or not to make such an amendment:

(a) Whether the taxpayer has consistently asserted that they are entitled to take tax positions reflecting the court decision;
(b) Whether the taxpayer has been associated with claims or actions against Inland Revenue on issues relevant to the request;
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(c) Whether Inland Revenue has advised the taxpayer that the outcome of a particular issue would apply to them; and

(d) Whether Inland Revenue has previously advised the taxpayer directly in relation to particular matters and the taxpayer has acted on that advice, which has later proved to be incorrect.

The CIR will not usually amend an assessment if a taxpayer makes an amendment request because of a change in the CIR’s practice in administering the tax laws (unless the change in practice is backdated). When an amendment request is the subject of a current dispute under Part 4A, the CIR will not amend the assessment except to reflect agreed adjustments and if there are no other disputed issues in the period to which the agreed adjustments relate. The CIR’s ability to amend assessments and make refunds of tax is limited by s 108 of the TAA [see 60.70]; 108A of the TAA, [see 60.80], s RM 2, [see 1215.10] and s 45 of the GSTA 1985, [see 560.137].

Although the four-year time limits in ss 108 and 108A of the TAA restrict the ability of the CIR to amend an assessment so as to increase the amount of tax payable, they do not limit the CIR’s ability to amend an assessment so as to reduce the amount of tax payable. However, when a taxpayer applies for a reduction (credit adjustment) in an assessment after the four-year time limit expires, the CIR will reduce the credit adjustments requested by the taxpayer by any adjustments which would have increased the amount of tax payable (debit adjustments). If the debit adjustments exceed the credit adjustments, the CIR cannot increase the assessment outside the four-year time limit, but the CIR can decline to make the credit adjustments because amending the assessment in this situation would not ensure their correctness.

Taxpayers cannot challenge the exercise of the CIR’s discretion under s 113 of the TAA [TAA, s 138E(1)(e)(iv)], but the exercise of this discretion is subject to judicial review.

60.125 Correction of minor errors in subsequent returns [TAA, s 113A]

If a person makes an error in a return, the CIR may allow the person to correct it in the next return due following the discovery of the error if:

(a) The person has provided a return for income tax, FBT or GST, and the assessment includes one or more minor errors;

(b) The error was caused by a clear mistake, simple oversight or mistaken understanding on the person’s part; and

(c) For a single return, the total discrepancy caused by the error is $500 or less. For this purpose, income tax, FBT and GST are treated separately.

This provision applies from 7 December 2009.

60.130 Set-off of excess tax paid when taxpayer investigated [TAA, s 166]

When Inland Revenue investigates a taxpayer’s liability for tax over a number of successive years, it sometimes happens that, although there is an overall deficiency of tax, there is an overpayment of tax in one or more of those tax years. In these circumstances the CIR may, if the CIR considers it equitable, allow the overpayment to be offset against any tax due for any of the other tax years investigated, even if the time limit for making a refund [see 1215.10] has expired.

60.140 Assessment of shortfall penalties [TAA, s 94A]

The CIR may make or amend an assessment of a civil penalty in the same way as the CIR may make or amend an assessment of the tax to which it relates.

A shortfall penalty, unless it is a penalty under s 141ED (failure to pay an employer monthly schedule amount), must be assessed in the same way as the tax to which it relates, but separately from that tax.

The CIR may assess a shortfall penalty before or after unpaid tax has been assessed, or has become assessable or payable, or has been paid. If the CIR assesses a shortfall penalty for unpaid income tax before the passing of the annual taxing Act, the unpaid income tax is calculated by reference to the rates in the most recent annual taxing Act.
Unless a tax law specifically provides otherwise, a payment made by, or an amount applied on behalf of, a taxpayer on account of a shortfall penalty does not give rise to a credit towards or in respect of any other tax or tax liability.

### 60.150 Validity of assessments [TAA, s 114]

An assessment made by the CIR is not invalidated:

(a) Through a failure to comply with a provision of the TAA or another Inland Revenue Act; or

(b) Because the assessment is made wholly or partly in compliance with:

(i) A direction or recommendation made by an authorised officer on matters relating to the assessment; or

(ii) A current policy or practice approved by the CIR that is applicable to matters relating to the assessment.
Chapter 70
Associated Persons and Relatives

70.10 Overview
TaxNote: A new definition of “associated persons” applies as follows:
(a) For the purposes of the land sales provisions other than s CB 11 [see 880 LAND SALES], to land acquired from 6 October 2009. In the case of s CB 11, which relates to the disposal of land within 10 years of completing improvement, the new definition applies to land on which improvements are commenced from 6 October 2009 [see 70.60 to 70.85];
(b) For all other purposes, from the commencement of the 2010-2011 income year [see 770 INCOME YEAR AND BALANCE DATE].

For the definitions that applied for various purposes prior to these dates, see Staples Tax Guide 2010.
The associated persons and relatives provisions are anti-avoidance in nature. The assumption underlying these provisions is that taxpayers who have a close relationship with each other are more likely to enter into transactions on a non-arm’s length basis and avoid tax.

70.40 Nominees [s YB 21]
A person holds or does something as a nominee for another person if the person acts on the other person’s behalf. However, a trustee is a nominee only if the trustee is a bare trustee. If a person holds something or does something as a nominee for another person, the nominee is ignored. The person on whose behalf the nominee was acting is deemed to have done whatever the nominee has done on their behalf.

70.45 Relatives [s YA 1]
The word “relative” has the following three meanings in s YA 1:
(a) General meaning;
(b) Meaning for beneficiary income of minors; and
(c) Meaning for the purposes of the definition of “relative” in the Securities Act 1978.

(1) General meaning
Unless one of the two specific meanings explained below applies, the word “relative” means a person connected with another person by being:
(a) Within the second degree of blood relationship to the other;
(b) In a marriage, civil union, or de facto relationship with the other;
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(c) In a marriage, civil union, or de facto relationship with a person who is within the second degree of blood relationship to the other;
(d) An adopted child of the other;
(e) An adopted child of a person who is within the first degree of relationship to the other; or
(f) The trustee of a trust under which a relative of the other person has benefited or is eligible to benefit.

Meaning for beneficiary income of minors

For the purposes of s HC 36, the word “relative” is defined in s HC 36(5). Under that provision, the general definition above is extended to also include being in a marriage, civil union, or de facto relationship with:

(a) A person who is the adopted child of the other person;
(b) A person who is an adopted child of a person who is within the first degree of relationship to the other; or
(c) A person who is connected to the other person through guardianship.

The word “guardian” is defined in s 15 of the Care of Children Act 2004. Persons are connected by guardianship if one is the guardian of the other. However, “guardian” does not include a guardian appointed under any of the following:

(a) Section 110(1)(a) to (d) of the Children, Young Persons, and their Families Act 1989;
(b) Section 31 of the Care of Children Act 2004;
(c) Section 53 of the Public Trust Office Act 1957 by a Court order;
(d) Section 7(4) of the Adoption Act 1955.

Meaning for the purposes of the definition of “relative” in the Securities Act 1978

Section 2 of the Securities Act 1978 defines “relative” by reference to the meaning in the Income Tax Act 2007. The definition for this purpose is a person connected with another person by being:

(a) A person who is within the fourth degree of blood relationship to the other;
(b) Being in a marriage, civil union, or de facto relationship with the other;
(c) A person who is in a marriage, civil union, or de facto relationship with a person who is within the fourth degree of blood relationship to the other;
(d) A person who is adopted as a child of the other or as a child of a person who is within the third degree of relationship to the other; or
(e) A person who is the trustee of a trust under which a relative of the other person has benefited or is eligible to benefit.

This meaning applies for:

(a) Section CX 19 (benefits provided instead of allowances);
(b) Section EX 4 (limits to requirement to include associated person interests in the CFC and FIF rules);
(c) Section GB 27 (attrIBUTION rule for income from personal services);
(d) Section HG 11(12) (limitation on deducTIONS by partners in limited partnerships); and
(e) The 1988 version provisions of the associated persons definitions.

Degrees of relationship

The procedure for determining the degree of relationship between two persons is to count backwards from one of those persons to a common ancestor and then forward to the other person:

(a) The first degree of relationship is determined on the basis that a husband and wife or a parent and child are within the first degree;
(b) The second degree of relationship is that of either:
(i) Brothers and sisters to each other; or...
(ii) Grandparents and grandchildren to each other (this arises because it is necessary to count through two steps of first degree of relationship);

(c) The third degree of relationship is that of either:
   (i) Great grandparents and great grandchildren to each other; or
   (ii) Aunts and uncles to nephews and nieces (this arises because it is necessary to count through three steps of first degree of relationship);

(d) The fourth degree of relationship is that of either:
   (i) Great great grandparents and great great grandchildren to each other;
   (ii) Great aunts and great uncles to great nephews and great nieces; or
   (iii) First cousins to each other (this arises because it is necessary to count through four steps of first degree of relationship).

Example 1:
Alan and Barry are first cousins. Alan has a first degree of relationship with his mother and a second degree of relationship with his maternal grandmother, a third degree of relationship with his uncle (ie his mother’s brother), and a fourth degree of relationship with his first cousin Barry, as Barry is his uncle’s son.

Example 2:
Lyn and John are married. Therefore, they have a first degree of relationship with each other.

70.60 New “associated persons” definition: application dates

A new definition of “associated persons” applies as follows:

(a) For the purposes of the land sales provisions other than s CB 11 [see 880 LAND SALES], to land acquired from 6 October 2009.

(b) For the purposes of s CB 11, which relates to the disposal of land by a person in the business of erecting buildings or by their associates where that land is sold within 10 years of completing an improvement, the new definition applies to land on which improvements are commenced from 6 October 2009 [see 880.35].

(c) For all other purposes, from the commencement of the 2010-2011 income year [see 770 INCOME YEAR AND BALANCE DATE].

70.65 “Associated persons” definition: overview

The definition of “associated persons” consists of 12 basis tests of association.

The 12 basic tests are:

(a) Two companies which have common control;
(b) Company and a person other than a company;
(c) Two relatives;
(d) A person and a trustee for a relative;
(e) A trustee and a beneficiary of the trust;
(f) Trustees (ie trusts) which have a common settlor;
(g) A trustee (ie a trust) and a settlor of the trust;
(h) A settlor of a trust and a beneficiary of that trust;
(i) A trustee of a trust and a person with a power of appointment or removal of trustees;
(j) A partnership (including a limited partnership) and a partner in that partnership;
(k) A look-through company and an owner who is a director or employee in the LTC; and
(l) A look-through company and an owner who has effective look-through interests of 25 per cent or more.

**TaxNote:** Where a trustee is an associated person, it is the person in their capacity as trustee that is associated, not the person in their personal capacity.

These are then buttressed by two additional rules:

(a) The tripartite test which can deem two persons to be associated with each other if they are each associated with the same third person [see 70.75]; and

(b) The aggregation rules in the company and limited partnership tests which can deem a person (“A”) to hold anything which is held by another person (“B”) where “A” and “B” are associated persons of each other [see 70.80].

There are also a number of rules which vary the outcome of the general rules under specified circumstances.

**70.70 “Associated persons” definition: basic tests of association** [ss YB 2, YB 3, YB 4, YB 5, YB 6, YB 7, YB 8, YB 9, YB 10, YB 11, YB 12, YB 13]

The basic categories of “associated person” are:

(a) Two companies;

(b) A company and a person who is not a company;

(c) Two individuals who are relatives;

(d) Person and a trustee for a relative of that person;

(e) Trustee and beneficiary;

(f) Two trusts with common settlor;

(g) Trustee and settlor;

(h) Settlor and beneficiary;

(i) Trustee and person with power of appointment or removal;

(j) Partnership and partner;

(k) Look-through companies and owners of interests; and

(l) Other specific tests.

(1) **Two companies** [s YB 2]

Two companies are associated persons of each other if there is a group of persons whose voting or market value interests [see 170 COMPANIES] in each company total 50 per cent or more, or who control both companies by any other means.

**Example:**

A Co has only one class of share and these are owned as to 70 per cent by John and 30 per cent by Joseph. B Co also has only one class of share and these are owned as to 50 per cent by John and 50 per cent by Sam. As there is a group of persons (John) who has at least a 50 per cent interest in both A Co and B Co, the two companies are associated persons.

The following exceptions apply to the “two companies” rule:

(a) The “control by any other means” part of this test does not apply to two companies if either or both of them are:

(i) A State enterprise;

(ii) A Crown Research Institute;

(iii) A Crown health enterprise;

(iv) A company that is part of the same group of companies as State enterprise, a Crown Research Institute or a Crown health enterprise.
(b) For the purposes of the international tax rules [see 850 INTERNATIONAL TAX REGIME], two companies are not associated if one of them (but not both of them) is non-resident.

(c) For the purposes of the land sale provisions, two companies are not associated persons if one of them is a portfolio investment entity (PIE) or an entity that qualifies for PIE status.

(2) A company and a person who is not a company [s YB 3]

A company and a person other than a company are associated persons if the person has a voting interest or market value interest in the company of 25 per cent or more.

Example:
A Co has only one class of share and these are owned as to 80 per cent by John and 20 per cent by Joseph. John and Joseph are friends, but are not otherwise related. As John’s interest in the company is at least 25 per cent, John and the company are associated persons. As Joseph’s interest is less than 25 per cent, Joseph and the company are not associated persons.

For the purposes of this test, “a person other than a company” includes a company acting in its capacity as a trustee of a trust.

Example:
All of the shares in Jones Shoes Ltd are owned by the Jones Family Trust. The Trustee of the Jones Family Trust is Jones Family Ltd. Jones Shoes Ltd and Jones Family Ltd in its capacity as trustee (and therefore the Jones Family Trust) are associated persons.

(3) Two individuals who are relatives [s YB 4]

Two individuals are associated persons if any one or more of the following applies:

(a) They are within two degrees of blood relationship [see 70.50];

(b) They are married to each other or are in a civil union or de facto relationship with each other; or

(c) One of them is within two degrees of blood relationship to the other person’s spouse, civil union partner, or de facto partner.

Example:
Jason and his grandmother, Julie, are associated persons as they are within two degrees of relationship. Jason has entered into a civil union with Trevor. Julie and Trevor are associated persons under item (c).

Adopted children are treated as being a natural child of the adoptive parents and not of the birth parents.

An individual is not associated with another individual if the person cannot reasonably be expected to know of the existence of that other person and/or the fact that the other person is within two degrees of blood relationship.

Example:
Sam has not seen his mother since he was baby. His mother has now remarried and has a daughter, Julie. If Sam is not aware of the existence of Julie and/or is not aware of the fact that she is within two degrees of blood relationship to him, Sam and Julie will not be associated persons.

The relatives test of association is limited for the purposes of the land sale provisions [see 880 LAND SALES], the low turnover trader trading stock valuation [see 1400.15] and the transfer of livestock due to a self-assessed adverse event [see 430.05]. For these purposes, two individuals are associated with each other only if:

(a) They are married to each other or are in a civil union or de facto relationship with each other; or

(b) One is the infant child of the other.

(4) Person and a trustee for a relative of that person [ss YB 5, YB 16]

A trustee of a trust and relative of a beneficiary of that trust are associated persons. “Relative” means a person associated under s YB 4 (see above).
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**Example:**
Mary and her granddaughter, Mollie, are associated persons under s YB 4 as they are relatives within the second degree. Mary is an associated person of any trustee (ie trust) under which Mollie has benefited or is eligible to benefit.

This test of association does not apply:
(a) For the purposes of the land sales provisions;
(b) Where the trust is a lines trust established under the Energy Companies Act 1992;
(c) Where the trust is an approved unit trust referred to in cl 2 of the Income Tax Act (Exempt Unit Trusts) Order 1990 (ie bonus bonds).

**(5) Trustee and beneficiary**

A trustee of a trust and a person who has benefited or is eligible to benefit under the trust are associated persons.

**Example:**
Mollie is a beneficiary of the Jones Family Trust. As a beneficiary, Mollie is eligible to benefit from the trust. Therefore she is an associated person of the trustee (ie the trust).

This test of association does not apply:
(a) For the purposes of the land sales provisions;
(b) Where:
   (i) The trust is only for the benefit of employees; and
   (ii) Neither the beneficiary nor any person associated with the beneficiary directly or indirectly controls the trust;
(c) Where the trust is a lines trust established under the Energy Companies Act 1992;
(d) Where the trust is an approved unit trust referred to in cl 2 of the Income Tax Act (Exempt Unit Trusts) Order 1990 (ie bonus bonds); or
(e) Where the beneficiary is a charitable organisation.

**(6) Two trusts with common settlor [ss YB 7, YB 10, YB 15(2), YB 15(3)]**

Trustees of two trusts (ie two trusts) which have been settled by the same person are associated persons. For the purposes of this test, two persons who are married to each other, or who are in a civil union or de facto relationship with each other are treated as being the same single person.

**Example:**
Sam and Samantha are husband and wife. Sam has settled a trust for the benefit of Samantha and their children. Samantha has settled a trust for the benefit of Sam and their children. As Sam and Samantha are married, they are treated as being the same single person. Therefore, the two trusts have the same settlor. This means that the two trusts are associated persons of each other.

For the purposes of this test, “settlor” has the has the meaning set out in s HC 27 [see 1420.65] but does not include a person who provides services to a trust for less than market value.

This test does not apply in either of the following circumstances, both of which concern employee trusts:
(a) **Settlor is not a company:**
   (i) The settlor is not a company;
   (ii) The settlor settles property on the trust only for the benefit of the settlor’s employees; and
   (iii) Neither the settlor nor any person associated with the settlor directly or indirectly controls the trust.

(b) **Settlor is a company:**
   (i) The settlor is a company; and
   (ii) None of the following persons directly or indirectly controls the trust:
- The settlor;
- An executive of the settlor;
- A director of the settlor; or
- A person holding a direct voting or market value interest of 25 per cent or more in the settlor.

(7) **Trustee and settlor** [ss YB 8, YB 10, YB 15(2), YB 15(3)]

A trustee of a trust (ie a trust) and a settlor of that trust are associated persons.

For the purposes of this test, “settlor” has the meaning set out in s HC 27 [see 1420.65] but does not include a person who provides services to a trust for less than market value.

The following exceptions apply to this test:

(a) **Charitable trusts**: This test does not apply if the trust is a charitable trust.

(b) **Employee trusts where the settlor is not a company**: This test does not apply where:

   (i) The settlor is not a company; and
   (ii) The settlor settles property on the trust only for the benefit of the settlor’s employees; and
   (iii) Neither the settlor nor any person associated with the settlor directly or indirectly controls the trust.

(c) **Employee trusts where the settlor is a company**: This test does not apply where:

   (i) The settlor is a company;
   (ii) The settlor settles property on the trust only for the benefit of the settlor’s employees; and
   (iii) None of the following persons directly or indirectly controls the trust:
        - The settlor;
        - A person associated with the settlor;
        - An executive of the settlor;
        - A director of the settlor; or
        - A person holding a direct voting or market value interest of 25 per cent or more in the settlor.

(8) **Settlor and beneficiary** [ss YB 9, YB 10, YB 15(2), YB 15(3), YB 16]

A settlor of a trust (ie a trust) and a person who has benefited or is eligible to benefit under the trust are associated persons. For the purposes of this test, “settlor” has the meaning set out in s HC 27 [see 1420.65] but does not include a person who provides services to a trust for less than market value.

The following exceptions apply to this test:

(a) **Land sale provisions**: This test does not apply for the purposes of the land sale provisions.

(b) **Employee trusts where the settlor is not a company**: This test does not apply where:

   (i) The settlor is not a company;
   (ii) The settlor settles property on the trust only for the benefit of the settlor’s employees; and
   (iii) Neither the settlor nor any person associated with the settlor directly or indirectly controls the trust.

(c) **Employee trusts where the settlor is a company**: This test does not apply where:

   (i) The settlor is a company; and
   (ii) The settlor settles property on the trust only for the benefit of the settlor’s employees; and
   (iii) None of the following persons directly or indirectly controls the trust:
        - The settlor;
        - A person associated with the settlor;
        - An executive of the settlor;
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- A director of the settlor; or
- A person holding a direct voting or market value interest of 25 per cent or more in the settlor.

(d) Charities: This test does not apply where the beneficiary is a charitable organisation.

(9) Trustee and person with power of appointment or removal [ss YB 11, YB 15(4)]

A trustee of a trust (ie the trust) and a person who has a power of appointment or of removal of the trustees of that trust are associated persons. This test does not apply to a trust that is only for the benefit of employees where neither the person who has a power of appointment of trustees, nor an associated person of that person, directly or indirectly controls the trust.

(10) Partnership and partner [s YB 12]

A partnership and a partner in the partnership are associated persons.

In the case of a limited partner in a limited partnership, a different test applies. A limited partnership and a limited partner are associated persons if the limited partner has a 25 per cent or greater interest in the limited partnership. This is calculated on the basis of a partnership share in a right, obligation, or other property, status, or thing of the limited partnership.

TaxNote: The scope of all of the above tests can be broadened significantly by the application of the tripartite test and the aggregation rules [see 70.75 to 70.85].

(11) Look-through company and owners of interests [s YB 13]

A look-through company and a person who has a look-through interest in the company and is a director or employee of the look-through company are associated.

Also associated are a look-through company and a person who has a 25 per cent or greater interest in any right, obligation, or other property interest or thing in the look-through company. For this test, the interests of any two persons who are associated under any of ss YB 2 to YB 11 and YB 14 are aggregated.

For the purposes of the land provisions, the aggregation rule applies to two persons who are associated under any of ss YB 2, YB 3, YB 4(1)(b) and YB 4 (2) to YB 4 (4), YB 7, YB 8, YB 10, YB 11 and YB 14.

(12) Other specific tests

Specific tests of association apply for various provisions in the Act:

(a) Section DS 4(5) provides that a shareholder in a loss-attributing qualifying company (LAQC) and that LAQC are treated as associated persons for the purposes of s DS 4 (meaning of film reimbursement scheme).

(b) Section EB 13(2) provides a special rule for the purposes of subpart EB (valuation of trading stock (including dealer’s livestock)) to determine when a low-turnover trader is associated with a company.

(c) Section EX 4(1) provides a special rule for the purposes of s EX 3 to determine when a New Zealand resident is associated with a non-resident relative under the controlled foreign company and foreign investment fund rules.

(d) Section LP 2(6) provides a special rule applies for the purposes of s LP 2 to determine when a company is associated with a supplementary dividend holding company.

70.75 Tripartite test [s YB 14]

The tripartite test provides that two persons are associated persons where they are both associated with the same third person. However, the test applies only where each is associated with the third person under a different test of association.

Example 1:
Sam has settled a family trust for the benefit of her children. She also holds all of the shares in a family company. Sam and the trust are associated persons by virtue of s YB 8 (trustee and settlor). Sam and the company are associated persons by virtue of s YB 3 (a company and a person other than a company). As both the trust and the company are associated with the same person
(Sam) and the association arises under different limbs of the associated persons tests, the family trust and the company are associated persons.

Example 2:
Josh holds 30 per cent of the shares in A Co and 40 per cent of the shares in B Co. There is no other person who holds shares in both companies. Josh is an associated person of each of the companies by virtue of s YB 3 (company and a person other than a company). However, as both companies are associated with the same third person (Josh) under the same limb of the associated persons tests, Josh’s shareholdings do not result in the two companies being associated with each other under the tripartite test.

70.80 Tripartite aggregation rules [ss YB 2, YB 3, YB 12]

There are three aggregation rules which broaden the scope of the associated persons definition.

The first is contained in s YB 2 and applies when determining whether or not two companies are associated with each other. The second, in s YB 3, applies when determining whether a company is an associated person of a person who is not a company. The third, in s YB 12 applies in determining whether a limited partner is an associated person of a limited partnership.

In each case, a different, and more limited, test applies for the purposes of the land sales provisions.

(1) Two companies — general rule

For the test of when two companies are associated, if two persons (person A and person B) are associated under any of the tests in ss YB 4 to YB 14, person A is deemed to hold anything held by person B. Sections YB 4 to YB 14 include all of the tests other than the “two companies” and the “company and a person other than a company” tests. It also includes the tripartite test [s YB 2(4)].

Example:
Janet and Colin are brother and sister. Therefore, Janet and Colin are associated persons under s YB 4. Janet owns all of the shares in J Co and is therefore an associated person of J Co. Colin owns all of the shares in C Co and is therefore, an associated person of C Co. Under the aggregation rule, John is deemed to hold anything held by Janet (ie the shares in J Co) and Janet is deemed to hold anything held by Colin (ie the shares in C Co). As all of the shares in each of the companies are deemed to be held by the same person (either Janet or Colin), the two companies are associated persons of each other.

(2) Two companies — land sales provisions

For the purposes of the land sales provisions, the test is a little narrower. In order for person A to be deemed to hold anything held by person B, A and B need to be associated persons under any one of ss YB 4(1)(b) and (2) to (4) (one is the other’s spouse or infant child), YB 7 (two trusts with a common settlor), YB 8 (trustee and settlor), and YB 10 to YB 14 (trust and a person with the power to appoint a trustee, partner and partnership, and the tripartite test) [s YB 2(5)].

(3) Company and a person other than a company — general rule

For the test of when a company and a person other than a company are associated, if two persons (person A and person B) are associated under any of the tests in ss YB 4 to YB 14, person A is deemed to hold anything held by person B. Sections YB 4 to YB 14 include all of the tests other than the “two companies” and the “company and a person other than a company”. It also includes the tripartite test [s YB 3(3)].

Example:
Richie and Temepara are father and daughter. Richie owns all of the shares in R Co and Temepara owns all of the shares in T Co. Richie and Temepara are associated persons under s YB 4. Under the aggregation rule, Richie is deemed to hold anything held by Temepara (ie the shares in T Co). Therefore, Richie and T Co are associated persons. The same applies for R Co and Temepara.

(4) Company and a person other than a company — land sales provisions

For the purposes of the land sales provisions, the test is a little narrower. In order for person A to be deemed to hold anything held by person B, A and B need to be associated persons under any one of ss YB 4(1)(b) and (2) to (4) (one is the other’s spouse or infant child), YB 7 (two trusts with a common settlor), YB 8 (trustee and settlor), and YB 10 to YB 14 (trust and a person with the power to appoint a trustee, partner and partnership, and the tripartite test) [s YB 3(4)].
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(5) Limited partnerships — general rule
For the test of when a limited partner and a limited partnership are associated persons, if two persons (person A and person B) are associated under any of the tests in ss YB 2 to YB 11 and YB 14, person A is deemed to hold anything held by person B. Sections YB 2 to YB 11 and YB 14 include all of the tests other than the “partner and partnership” test. It also includes the tripartite test [s YB 12(3)].

Example:
Aaron and Becky are grandfather and granddaughter. Becky is a limited partner in the Becketal Ltd Partnership, holding a 30 per cent interest. As Aaron and Becky are associated persons, Aaron is deemed to hold anything held by Becky (ie the partnership interest). Therefore, Aaron and Becketal Ltd Partnership are associated persons.

(6) Limited partnerships — land sale provisions
For the purposes of the land sales provisions, the test is a little narrower. In order for person A to be deemed to hold anything held by person B, A and B need to be associated persons under any of ss YB 2, (two companies), YB 3 (company and a person other than a company), YB 4(1)(b) and (2) to (4) (one is the other’s spouse or infant child), YB 7 (two trusts with a common settlor), YB 8 (trustee and settlor), YB 10 and YB 11 (trust and a person with the power to appoint a trustee) and YB 14 (the tripartite test) [s YB 12(4)].

70.85 Tripartite test and aggregation rule operating in tandem
As the tripartite test and the aggregation rules operate in tandem, they have the potential to significantly increase the scope of the associated persons rules.

Example:
Daisy settles a trust for the benefit of her husband, Donald and their three sons, Huey, Duey and Luey. The trust owns all of the shares in Duck Co which, in turn, owns a large block of bare land. Donald is a land developer. Are Donald and Duck Co Ltd associated persons of each other?

Donald is an associated person of Daisy as they are the spouse of each other [s YB 4]. Daisy is an associated person of the trust as she is the settlor of the trust [s YB 8].

As Daisy is associated under different tests with both Donald and the trust, Donald is an associated person of the trust under the tripartite test [s YB 14].

As Donald is an associated person of the trust, he is deemed to hold anything held by the trust (ie the shares in Duck Co Ltd under the both the general aggregation rule and under the aggregation rule relating to land [ss YB 3(3), YB 3(4)]).

As Donald is deemed to hold the shares in Duck Co, he is an associated person of Duck Co [s YB 3].
Chapter 80
Avoidance

80.05 Overview
The tax avoidance provisions have been a difficult set of rules to apply, as indicated by the volume of litigation now appearing. These provisions primarily target transactions that apply tax rules in a manner contrary to the intention of those rules. The anti-avoidance rules either have general application or target specific transactions.

80.10 Definitions [s YA 1]
Section YA 1 provides the following definitions:

“Arrangement” means any agreement, contract, plan, or understanding (whether enforceable or unenforceable) including all steps and transactions by which it is carried into effect.

“Tax avoidance” is defined as including:
(a) Directly or indirectly altering the incidence of any income tax;
(b) Directly or indirectly relieving any person from liability to pay income tax; and
(c) Directly or indirectly avoiding, postponing, or reducing any liability to income tax.

“Tax avoidance arrangement” is defined in s YA 1 as an arrangement, whether entered into by the person affected by the arrangement or by another person, that directly or indirectly:
(a) Has tax avoidance as its purpose or effect; or
(b) Has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental.

80.15 General income tax anti-avoidance provisions [ss BB 3, BG 1, and GA 1]
Sections BB 3 and BG 1, in conjunction with s GA 1, contain the general anti-avoidance rules. The following discussion explains how these rules provide the CIR with the authority and mechanisms to counteract tax avoidance.

A tax avoidance arrangement is void against the CIR for income tax purposes [s BG 1(1)]. The CIR, in accordance with Part G (Avoidance and Non-Market Transactions), may counteract a tax advantage obtained by a person from or under a tax avoidance arrangement [s BG 1(2)].
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Where the avoidance is in the form of claiming tax credits, the CIR may disallow the credits, in whole or in part, or allow another person to take the benefit of some or all of the tax credits if the credits are part of a tax avoidance arrangement [s GA 1(3)].

Section GA 1 is a reconstruction provision and gives the CIR the power to adjust assessable income, deductions, and tax losses and tax credits to counteract the tax advantage arrangement.

The section will apply if tax avoidance is only one of the purposes or effects but it must be something more than being merely an incidental purpose or effect. This statutory wording overcomes a difficulty which had developed in New Zealand under an earlier anti-avoidance provision in s 108 of the Land and Income Tax Act 1954 as a result of the decision in Mangin v Commissioner of Inland Revenue [1971] NZLR 591, (1970) 1 ATR 835 (PC). In this case, the Privy Council considered that an arrangement could not be set aside unless tax avoidance was, if not the sole purpose, the principal purpose of the arrangement. It is interesting to note that the Australian Courts did not appear to go along with this approach in relation to s 260 of the Australian Act, which was their counterpart anti-avoidance section. In Hollyock v Federal Commissioner of Taxation (1971) 2 ATR 601 (HCA) at 606 the High Court of Australia distinguished Mangin's case holding:

“To say that the section applies only to arrangements whose sole purpose is tax avoidance would be contrary to the decisions in Newton’s and Hancock’s cases. …

“To hold that tax avoidance should be the principal purpose of the arrangement would seem to me to be opposed to the reasoning on which these decisions rest, and would introduce into s 260 a refinement which is not suggested by the words of the section itself … on the other hand, if tax avoidance is an essential or incidental feature of the arrangement, that may well serve to show that the arrangement cannot necessarily be labelled as a means to avoid tax.”

In Federal Commissioner of Taxation v Gulland (1985) 17 ATR 1, 85 ATC 4,765, the Australian High Court considered three separate instances where doctors sold their respective medical practices to unit trusts in which their family trusts held the units. The doctors then became employees of the unit trusts. By majority decision the Australian Tax Office was held entitled in each instance to void the arrangement for the purposes of assessing income tax.

The definition of “tax avoidance arrangement” [s YA 1] ensures that an arrangement that gives rise to an incidental tax avoidance effect will be subject to the general anti-avoidance provisions except where that effect is incidental to the arrangement. In addition, this definition encompasses an arrangement that gives rise to a tax avoidance effect directly or indirectly. This ensures that taxpayers cannot place themselves outside the scope of the section by arranging for a trustee of a family trust to enter into an arrangement that gives rise to a tax avoidance effect for those taxpayers through the trust.

The provisions also apply whether or not the arrangement can be explained or is referable to ordinary business or family dealings. Previously, the Courts tended to accept the view that if a particular arrangement could be explained by ordinary family or business dealings, the arrangement would be acceptable — no matter how significant the element of tax avoidance was. The reference to ordinary family or business dealings could be put in its proper perspective by the following example: if a farmer transfers his farm outright to his family trust, the CIR’s would views this transaction as falling outside the scope of the avoidance sections as any reduction in tax could be regarded as being merely an incidental feature. On the other hand, if the farmer merely leased a part of the farm to his family trust under a “paddock trust arrangement”, the transaction would fall within the scope of the avoidance sections. The taxpayer could not claim that the significant element of tax avoidance present in the creation of the trust amounted to common practice simply because paddock trusts were so common in his particular area. Similarly, with share transactions, the CIR will accept that, if shares are sold in the ordinary course on the share market, the avoidance provisions will not apply [see 80.22]. However, if shares in a defunct company which has accumulated profits are sold, the CIR would consider that the avoidance sections may apply as tax avoidance is more than an incidental feature of the transaction. Again it would not be open to the taxpayer to argue that the selling of shares in these circumstances is so common that it would amount to ordinary business dealing and therefore explain the avoidance.

To sum up, the whole effect gives a close parallel to what Woodhouse J said in Elmiger v Commissioner of Inland Revenue [1966] NZLR 683 (SC):
“Accordingly it is my opinion that family or business dealings will be caught … despite their characteristics as such, if there is associated with them the additional purpose or effect of tax relief … pursued as a goal in itself and not arising as a natural incident of some other purpose.”

**80.20 Adjustments arising through the general income tax anti-avoidance provisions** [s GA 1]

Section GA 1 provides the following rules:

(a) Where an arrangement is void in accordance with s BG 1, the amounts of assessable income, deductions tax losses and tax credits included in calculating the taxable income of any person affected by that arrangement may be adjusted by the CIR in the manner the CIR thinks appropriate, so as to counteract any tax advantage obtained by that person from or under that arrangement;

(b) Without limiting the generality of this subsection, the CIR may have regard to such amounts of income, deductions tax losses and tax credits as, in the CIR’s opinion, that person would have, would in all likelihood have, or might be expected to have if that arrangement had not been made or entered into; and

(c) If the CIR includes any amount of income or deduction in calculating the taxable income of any person, it must not be included in the calculation of the taxable income of any other person.

In ordinary circumstances, the CIR considers that the income:

(a) Is assessable to the party who has attempted to divert the income; and

(b) Is assessable to that person as and when the income is derived by the other party to the arrangement.

However, there is specific provision made for dividend stripping in s GB 1) [see 80.22].

In *Miller v Commissioner of Inland Revenue* (1998) 18 NZTC 13,961 (CA), the Court reviewed the CIR’s use of s 99 of the ITA 1976 (now ss BG 1 and GA 1) to treat as void and to reconstruct two examples of an arrangement designed and marketed by Mr J G Russell.

Under this arrangement, a group of companies having tax losses bought a profit-making company from the plaintiffs. The plaintiffs largely retained control over their profit-making company, which continued to trade normally and make taxable profits. The loss company then offset those tax losses against the taxable profits of the profit-making company in order to reduce the group’s total income tax liability. The plaintiffs received their former company’s profits by way of loan repayments from the group, who had funded the purchase by mortgaging the shares in the plaintiffs’ company to the plaintiffs. Some of the profits went to the owners of the tax-loss company, and other payments and business arrangements occurred.

The CIR considered that the purpose and effect of the arrangement was tax avoidance, and applied the general income tax anti-avoidance provision [ITA 1976, s 99] to void this arrangement and assessed the profit-making company for tax that would otherwise have paid in the absence of the tax avoidance arrangement. However, because of risk that the profit making company would be stripped of its assets to leave it in a position of being unable to satisfy the assessed income tax liability, the CIR also assessed the plaintiff shareholders directly.

The taxpayers appealed, seeking a judicial review of the administrative processes in arriving at these assessments.

In reviewing the administrative processes involved, the Court of Appeal held that:

(a) The CIR’s assessment and process in arriving at the assessment were reasonable actions and as such, the motivations underlying the assessment were proper.

(b) Unless the assessments were invalid on other grounds, they could not be challenged except in objection proceedings.

(c) There was no reason why, if two taxpayers are liable in the alternative, the CIR should not select the more likely to be able to pay.

(d) To apply the general income tax anti-avoidance provision, the CIR must first come to a view on the legal nature or character of an arrangement. Following this, the CIR must form the view that the
purpose or effect, or a more than incidental purpose or effect of the arrangement is tax avoidance, and then decide how the arrangement is to be reconstructed.

(e) Where the CIR disallows a deduction for losses under the loss grouping rules [see 940 LOSSES], this does not prevent the CIR from assessing another party under the general income tax anti-avoidance provisions to counteract any tax advantage under a tax avoidance arrangement.

80.22 Share sales affected by the general income tax anti-avoidance provisions [s GB 1]

Section GB 1 provides the anti-avoidance rules for dividend stripping. The rules apply where, during an income year, a person disposes of shares in a company and the disposal is part of a tax avoidance arrangement. If some or all of the consideration that the person derives from the disposal is in substitution for a dividend that the person would have, in all likelihood would have, or might be expected to have derived, that amount is treated as a dividend derived by the person. The derivation of the dividend is deemed to occur in the income year in which the disposal occurs.

**TaxNote:** The sales of shares will not be caught unless tax avoidance was something more than a merely incidental purpose or effect of the sale. The provisions operate to assess so much of the full consideration as could be expected to have been received by way of dividends in the ordinary course of events. The dividends are deemed to be derived as and when the consideration is received and not as and when dividends are declared by the company in which the shares are sold.

**Example:**

A owns all the shares in X Ltd which has capital of $1,000 and accumulated profits of, say, $2,000. He is paid $2,800 for his shares which is calculated as 100 per cent of the capital and 90 per cent of the accumulated profits. The question is whether $2,000 is treated as dividends or $1,800. A literal interpretation is that the taxpayer in this case would be assessable on $2,000 and not $1,800.

In *Miller v Commissioner of Inland Revenue* (1998) 18 NZTC 13,961 (CA), the Court held that the CIR is not obliged to apply the dividend stripping rule to a tax avoidance arrangement if the CIR considers that another form of construction is preferable under s GA 1.

In *TRA Case P34* (1992) 16 TRNZ 836, these provisions were invoked and upheld by the TRA when an arrangement was entered into whereby a third company passed the consideration to the shareholders on a change in shareholdings in two other companies. The effect of the transactions was in the nature of tax avoidance and not mitigation. This was so because the effect of the arrangement was simply to reduce the taxpayers’ tax liability without involving them in any loss or expenditure which entitled them to that reduction.

80.25 Inland Revenue policy on general income tax avoidance

The CIR has issued interpretation guidelines for identifying a sham in TIB vol 9:11 (November 1997) at 7-8. The TIB gives the essential features of a sham, which are summarised here:

(a) There must be a common intention between parties to the sham that the acts done or documents executed do not create the legal rights or obligations which they appear to create.

(b) A sham is the act done or document executed that is intended to deceive a third person.

(c) A sham may exist at the commencement of an act or the execution of a document or emerge over time.

(d) Where a portion of a transaction is a sham, its effect is limited to that portion. The rest of the transaction is not considered a sham.

(e) To decide whether a transaction is a sham or an effective transaction, the character of the legal arrangements entered into and carried out must be considered. In considering the genuineness of the agreement (as evidenced by the documents), it is necessary to consider whether the meaning of the transaction in the documents is the true meaning, or not the true meaning, and whether the documents conceal the true nature of the transaction.
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A Court will do its best to give effect to the intentions of the parties. There is no sham where transactions are intended to take effect and do take effect between the parties for example, where the transactions have the effect of fraudulently preferring one creditor to others, even if this result was deliberately planned. The transaction cannot be construed as giving a false or misleading impression to a third party.

A policy statement on how the CIR applies the general anti-avoidance legislation was released in February 1990: TIB vol 1:8 (February 1990). The focus of the policy is to evaluate arrangements in terms of whether they frustrate the underlying scheme and purpose of the relevant legislation. The CIR approach is to make a careful and thorough analysis of:

(a) The underlying scheme and purpose of the Act as a whole and of the specific provision under review;
(b) The arrangement, to ascertain its purpose or effect;
(c) Whether a fair and reasonable inference can be drawn that tax avoidance is one purpose of the arrangement (other than merely incidental); and
(d) Whether following this analysis it can be inferred that the arrangement frustrates the underlying scheme and purpose of the legislation.

Relationship to other sections of the Income Tax Act

The question has been raised as to whether taxpayers run foul of the general anti-avoidance provisions when they take advantage of a specific benefit or allowance expressly provided by the Act itself. Based on dicta from the Courts, the CIR would normally accept that, if taxpayers take advantage of specific provisions of the Act, they are doing no more than establishing their true liability for tax and therefore cannot be said to have avoided any tax in doing so. This is in line with the decision in the Australian case of Cridland v Federal Commissioner of Taxation (1977) 8 ATR 169 (HCA), in which the taxpayer entered into a transaction under which he became a beneficiary of a trust in which the trustees were carrying on business as primary producers. The Australian Income Tax Assessment Act provides that a beneficiary of such a trust is deemed to be carrying on the business of the trustees, with the consequence that the taxpayer became entitled to certain concessions available to primary producers, and so reduced his tax liability. It was held that the Australian anti-avoidance s 260 did not apply because an arrangement, the purpose or effect of which is to qualify a taxpayer for taxation concessions specifically provided by the Act, is not an arrangement having the purpose or effect of tax avoidance. However, if the taxpayer creates artificial situations to take undue advantage of specific provisions in the Act, he could well run foul of the section.

Fiscal nullity doctrine

The “fiscal nullity” doctrine arose from the decisions in WT Ramsay Ltd v Inland Revenue Commissioners (1981) 54 TC 101 (HL) and Inland Revenue Commissioners v Burmah Oil Co Ltd (1980) 54 TC 200 (HL). In effect, the doctrine requires no reference to be made to specific anti-avoidance legislation and merely results in the holding of a transaction ineffective for taxation purposes if its only purpose was to obtain a tax advantage. Application of the doctrine requires both a preconceived series of transactions and steps which have no business or commercial purpose other than that of achieving a tax advantage. The types of transactions subject to the doctrine were extended in Funniss v Dawson (1984) BTC 71 (HL).

The prime importance of the doctrine in New Zealand is that it was applied by the Privy Council in its interpretation of s 99 in Commissioner of Inland Revenue v Challenge Corp Ltd (1986) 8 NZTC 5,219 (PC).

The doctrine was applied in Magnavox Electronics Co Ltd v Hall (1986) BTC 455, where it was held that artificial transactions had occurred which had no purpose other than tax avoidance.

However, in several circumstances English Courts have not applied the doctrine. In Craven v White (1985) BTC 418 (HL), the Court held the doctrine inapplicable as a proper commercial purpose existed for the transaction. Hindsight could not be applied to fix a single purpose of tax avoidance when in reality at the relevant time a dual purpose existed. In Reed v Nova Securities Ltd (1985) BTC 121 (HL), the House of Lords did not apply the doctrine to a transaction where an advantage was sought under a specific statutory
Avoidance provision. The approach of Craven v White has been followed in both Inland Revenue Commissioners v Bowater Property Developments Ltd (1985) BTC 8,071 (HL) and Baylis v Gregory (1986) BTC 22 (EWCA). In Australia, the High Court in John v Federal Commissioner of Taxation (1989) 20 ATR 1, 89 ATC 4,101 (HCA) expressly rejected the doctrine, holding it inappropriate for interpretation of the Australian Income Tax Assessment Act either generally or for a specific provision.

In contrast to the fiscal nullity doctrine, the New Zealand Courts have generally adopted an approach to the effect that the legal character of a transaction is decisive and not the overall economic consequences to the parties. The documents themselves may only be brushed aside if and to the extent they are sham.

The above approach originated in the case of Inland Revenue Commissioners v Duke of Westminster [1936] AC 1 (HL) and has subsequently been approved in the cases of Re Securitibank Ltd (No 2) [1978] 2 NZLR 133 (CA), Commissioner of Inland Revenue v Europa Oil (New Zealand) Ltd [1971] NZLR 641 (PC), and Buckley & Young Ltd v Commissioner of Inland Revenue [1978] 2 NZLR 485, (1978) 3 NZTC 61,271 (CA).

80.45 Leading decisions
(1) The Ben Nevis decision

The Supreme Court case of Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue (2009) 24 NZTC 23,188 (SC), was an appeal from the Court of Appeal case Accent Management Ltd v Commissioner of Inland Revenue (2007) 23 NZTC 21,323 (CA), which was itself an appeal from the High Court decision in Commissioner of Inland Revenue v Accent Management Ltd (2005) 22 NZTC 19,027 (HC). Ben Nevis Forestry Ventures Ltd was a party to that case.

(a) Facts

The case involved investors in a syndicate called “Southern Lakes Joint Venture”, which was involved in forest development in the Southland region. The forest is to be harvested in 2048.

A three-tiered structure was used for the arrangement. The Trinity Foundation Charitable Trust held the shares in Trinity Foundation Ltd, which in turn owned Trinity Foundation (Services No 3) Ltd (“Trinity 3”). Trinity 3 owned the land on which the forest was planted. Southern Lakes Forestry Ltd acted as the agent for the joint venture.

The arrangement involved an occupation licence (and later a licence agreement) between Trinity 3 and Southern Lakes Forestry to carry on the forestry business on the land owned by Trinity 3. This agreement provided for $2,050,518 per plantable hectares in the land (484 ha). The licence term was from 24 March 1997 to 31 December 2048, by which time the cutting and extraction was to be completed. This agreement also set out the priority order for the application of proceeds of sale.

A further payment from the investors to Trinity 3 was payable on 21 March 1997, being the amount of $1,250 per hectare for the establishment of the forest and a further $1,946 per hectare for an option to purchase the land in 2048. Investors were required to pay a further $1,000 each for a lease option and $50 per annum licence fee. The licence premium was to be paid from the eventual sale of the trees.

To cover the contingency that the proceeds would be insufficient to cover the premium cost, insurance was taken out by the individual investors with CSI Insurance Group (BVI) Ltd, which was incorporated in the British Virgin Islands for the specific purpose. The insurance covered any event which prevented the market value at sale being at least $2,050,518 per hectare between the time of the event and 31 December 2048. The insurance premiums payable by the investors were $1,307 per hectare in 1997, and $32,791 per hectare payable on or before 31 December 2047, and $410,104 per hectare on or before 31 December 2047 for Trinity 3. The premium payable by Trinity 3 was to scale dollar for dollar up to a maximum of $1,230,311 per hectare to the extent that the market value of stumpage at 13 December 2047 would be less than $2,050,518 per hectare. The scaling resulted in the CSI being potentially liable for a maximum of only $787,416 per hectare, even though the insured amount was $2,050,518 per hectare.
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The obligations of the syndicate members to pay the licence premium and to meet their liability to pay the insurance premium in 2047 were covered by way of promissory notes issued by the members. These promissory notes were secured by way of debenture, thereby giving CSI first rights over the forest.

Deductions claimed by the investors in relation to their proportionate shares in the syndicate were as follows:

1997 income year:
(a) Insurance premiums of $34,098 per hectare being $1,037 paid in March 1997 and $32,791 to be paid in cash terms in 2047; and
(b) A small portion of the licence premium to be paid in 2048 as a depreciation allowance.

1998 income year:
(a) The amortised licence premium figure of about $41,000 per hectare.
(b) Excluding the actual costs of planting and tending trees over which there was no issue, investors had outlaid less than $5,050 per hectare in order to qualify for the deductions (which exceeded $75,000).
(c) This result was achieved by way of the application of specific provisions of the Income Tax Act.
(d) The licence premium gave rise to “a right to use land” which is depreciable property. As such, it is able to be depreciated.
(e) The insurance contract falls outside of the definition of “accrual expenditure” and, therefore, did not need to be spread.

(b) The general anti-avoidance provision

The Court found that the specific provisions in the Act are meant to work in tandem with the general anti-avoidance provision. Ascertaining whether the deployment of a specific provision crosses the line and turns what may otherwise be a permissible arrangement into a tax avoidance arrangement should be firmly grounded in the statutory language of the provisions themselves, rather than seizing on past judicial glosses and elaborations on the statutory language.

Where a taxpayer relies on a specific provision, the taxpayer must satisfy the Court that the provision has been used within its intended scope. If, viewing the arrangement as a whole, use of the specific provision alters the incidence of tax in a way which cannot have been within the contemplation and purpose of Parliament, the arrangement will be a tax avoidance arrangement. In this case, the licence premium fell within the specific provision as “a right to use land” but, viewing the arrangement as a whole, had additional features which caused it to represent, and be part of, a tax avoidance arrangement.

The general anti-avoidance provision does not confine the Court as to matters which may be taken into account when considering whether a tax avoidance arrangement exists, and the significance of relevant factors depend on the particular facts of the case.

A classic indicator of a use of a provision in such a way that it is outside the contemplation of Parliament is the structuring of the arrangement in such a way that the taxpayer gains the benefits of the specific provision in an artificial or contrived way. The ultimate question is whether, viewed in a commercially and economically realistic way, the arrangement makes use of the specific provision in a manner that is consistent with Parliament’s purpose.

(c) The licence premium

The Court found that the expenditure on the licence premium was incurred when the promissory notes were executed. However, the giving of promissory notes before the expenditure was incurred introduced an artificial element to the arrangement. The clarity of the tax advantage was in marked contrast to the prospect of any commercial profit. Thus, it was concluded that the primary, if not sole, purpose of the promissory note was to generate a tax deduction for the licence premium. Also, the timing difference between the incurring of the expenditure on the licence premium and the commercial payment of it, meant that the taxpayers would receive the benefits of tax deductions but probably never incur the real expenditure.
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(d) **The insurance**

The Court found that the formation of a special, single purpose, company in a tax haven to undertake the insurance risk, suggested that CSI was not intended to be anything more than a pro forma vehicle for obtaining the anticipated tax benefits. A letter of comfort given to CSI by the Trinity Foundation Charitable Trust provided a substantial element of circularity to the entire insurance arrangement. This led to the inference that the insurance was nothing more than a method whereby substantial tax benefits could be obtained by deducting one lump sum in 1997 for a premium which was not payable in commercial terms until 2047. The insurance arrangements were a material contributor to the whole Trinity scheme being a tax avoidance arrangement.

(e) **Conclusion**

The use by the taxpayers of specific provisions was not within Parliament’s purpose and contemplation when it authorised deductions of the kinds in question. The taxpayers altered the incidence of tax by means of a tax avoidance arrangement which was void as against the CIR. All taxpayers entered into a tax avoidance arrangement simply by virtue of the fact that they became members of the syndicate and parties to the agreements with Trinity 3. Once the existence of a tax avoidance arrangement has been established, all those taxpayers who have benefited from it may be subject to adjustments by the CIR, even where the taxpayer is not aware of the tax avoidance aspect or not directly involved.

(f) **Penalties**

Although the expenditure for the licence premium and the insurance premium satisfied the ordinary meaning of the specific provision, this was not enough on its own. The Court had concluded that the arrangement was clearly a tax avoidance arrangement and therefore the taxpayers took an incorrect tax position. The taxpayers had failed to meet the required standard of “about as likely as not to be correct”. The dominant purpose to be considered is the dominant purpose of the arrangement itself, not the dominant purpose in the minds of each taxpayer. It followed that the taxpayers each took an abusive tax position and were liable for the 100 per cent penalty imposed by legislation.

(g) **Practical application of the Ben Nevis decision**

The approach adopted by the Court in *Ben Nevis* was followed in the High Court case of *Westpac Banking Corporation v Commissioner of Inland Revenue* (2009) 24 NZTC 23,834 (HC). Between 1998 and 2000, Westpac entered into a number of structured finance deals with foreign counter-parties. The CIR was of the view that the transactions amounted to tax avoidance. There were a number of such transactions typically involving Westpac acquiring redeemable preference shares from a subsidiary. This was structured as a sale and buy-back transaction under which the subsidiary was obliged to repurchase the shares at the termination of the arrangement. The shares carried a fixed rate of dividend receivable by Westpac. The dividend, which was calculated to share the tax benefits arising from the deals, was exempt from tax and, due to the operation of the conduit tax mechanism (for most of the transactions) or the foreign tax credit regime (for one of the transactions) and was also relieved from the application of the foreign dividend withholding payment regime. The subsidiary’s obligation to repurchase the shares was covered by a guarantee which Westpac procured from the counter-party in return for a guarantee procurement fee (“GPF”). Westpac borrowed funds to finance the transaction and entered into a swap whereby Westpac paid interest at a fixed rate and received interest at a floating rate. The deductions claimed by Westpac for the funding costs and the GPF exceeded the dividends that it received. However, the tax exempt nature of the dividend resulted in the overall transaction being commercially profitable. Similar transactions were entered into by a number of New Zealand’s major trading banks.

The issue considered by the Court was stated as being whether, by using all of the specific provisions — both the conduit and FTC regimes for income and the interest deductibility provisions for expenditure — Westpac crossed the line and changed the character of the transactions from lawful to unlawful. That inquiry will take into account:

(a) The nature of the contractual relationship between Westpac and the counter-party and the legal effects of the documents;
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(b) The economic substance of the transaction (investment or loan);
(c) The structure of the transaction and whether Westpac obtained the benefit of the specific provisions in an artificial or contrived way, including but not limited to:
   (i) The existence and amount of the GPF, the circumstances in which it was agreed, and its objective value – that is, whether it was at a market or commercial rate;
   (ii) The use of a pricing mechanism to fix the dividend rate and in particular whether it provided for the parties to share all of Westpac’s taxation benefits — that is, both cross-border and domestic asymmetries;
   (iii) The cost of funds to Westpac and the profitability of the transaction (both pre and post-tax);
   (iv) The relationship between a transaction and the relevant level of Westpac’s tax shelter or estimated tax ratio;
   (v) The use of currency and interest swaps (both internal and external); and
   (vi) The financial consequences of the transaction.

In respect of the Ben Nevis decision, Harrison J:

(a) Stated that the Ben Nevis and Glenharrow decisions render analysis of previous avoidance case law unnecessary;
(b) Accepted the CIR’s submission that the cases are not a restatement of existing law, and represent a rejection of Richardson J’s juristic scheme and purpose approach in Challenge;
(c) Disagreed with the CIR’s submission that the avoidance provisions only bite once the Court is satisfied that the specific provisions have been complied with;
(d) Referred to the factors for consideration listed at [108]-[109] of Ben Nevis and stated that:
   (i) Ben Nevis represents “a significant shift in identifying the principles to be applied when construing s BG 1, mandating a broader inquiry than was previously required”;
   (ii) “The previous constraints imposed by a legalistic focus, to the exclusion of economic realism, have gone”;
   (iii) Ben Nevis prescribes “a combined form and substance test”;
   (iv) The ratio of Ben Nevis is “designed to prescribe the permissible scope of the substance inquiry”;
(e) Noted Glenharrow’s emphasis that anti-avoidance provisions are concerned with the purpose of the arrangement, not the purpose of the parties. Subjective intention may be relevant to the issue of whether there was (for example) a business purpose for a scheme.

A more comprehensive discussion of the Westpac decision can be found in TIB vol 21:9 (December 2009), at 19-21.

(2) Penny and Hooper v Commissioner of Inland Revenue [2011] NZSC 95

(a) The decision

The taxpayers, both orthopaedic surgeons separately and in different circumstances established structures with common features, a registered company of which the taxpayer was the sole director and in which the shares were held by family trusts. Each then sold their orthopaedic practice, from which they had been deriving a substantial income, to the company for a consideration which included an amount of goodwill. They each became an employee of the company. The practice continued as before but the staff previously employed by the taxpayer were employed by the company, patients were billed by the company (rather than the taxpayer) and equipment and other assets owned (or leased from an associated entity) by the company. From the point (1 April 2000) at which the maximum personal tax rate was increased from 33 cents in the dollar to 39 cents in the dollar, each taxpayer received from his company remuneration well below the level he had earned when he conducted the practice in his own name (the timing was a coincidence that did not go unnoticed by the Courts). The balance of the annual net practice income was distributed to the family trust
as a dividend and taxed at the 33 cent rate for trustee income (or the rate for individual beneficiaries). The effect was the taxpayers and their family were relieved from payment of the additional six cents in the dollar with savings of $20,000 - $30,000 per annum for the each taxpayer in the years in issue.

With respect to the taxpayer, Mr Penny, he established a company/trust structure several years before the increase in the maximum individual tax rate and at a time when he would have obtained no tax advantage from use of the structure. After the tax rate change Mr Penny limited the level of his salary and arranged for his family trust to lend back to him interest free and with no repayment terms, a large part of the distributions of company profits that it received by way of dividend.

The CIR made assessments increasing the taxable incomes of the taxpayers in the years ending 2002, 2003 and 2004 by an amount equal to the difference between the salaries actually paid and what the CIR assessed as commercially realistic salaries. The CIR contended that the taxpayers’ arrangements had the purpose or effect of tax avoidance in terms of s BG 1. In Penny v Commissioner of Inland Revenue [2009] 3 NZLR 523 the High Court held that what the taxpayers did was not an arrangement which had the purpose or effect of tax avoidance. In Commissioner of Inland Revenue v Penny (2010) 24 NZTC 24,287 by a majority, the Court of Appeal held the arrangements to be void against the CIR. The majority found that not only did the arrangements have the effect of altering the incidence of income tax but that was also at least one of its purposes and not merely an incidental purpose or effect. The issue before the Supreme Court was whether the way in which the taxpayers used their corporate and family structures constituted tax avoidance arrangements for the purposes of s BG 1.

The Supreme Court dismissed the taxpayers’ appeal. The case was different from Ben Nevis. In this case the Court found that there was no question of the taxpayers failing to comply with specific tax provisions. The structures they adopted were entirely lawful and did not in themselves involve tax avoidance. The taxpayers were entitled to make this choice. Further, there was nothing unusual or artificial in a taxpayer then causing the company under his control to employ him on a salaried basis. There was no failure to comply with any express requirement of the Act in the setting of the salaries since there is none. This was a case in which, compliance in other respects being accepted, the Court found it possible to move straight to s BG 1 and ask whether the use of the structure which was adopted when the salaries were fixed was beyond parliamentary contemplation and resulted in a tax avoidance arrangement.

The Court said that tax avoidance can be found in an individual step in a wider arrangement. That step, when taken, can make the wider arrangement a tax avoidance arrangement. Where a particular step is done repetitively, such as in this case in the annual setting of the salary levels, the step may or may not amount to a tax avoidance depending on its purpose or effect on each occasion. The question to be asked is why the salary was fixed as it was on a particular occasion. Whether that involved tax avoidance can be answered by looking at the effect produced by the fixing of the level of the salary in combination with the operation of the other features of the structure.

The Court noted that the fixing of the low salary enabled most of the profits of the company from the practice to be transferred by way of dividend straight through to the trust, avoiding payment of the highest personal tax rate, and then used by the trust for the taxpayer’s family purposes. Neither taxpayer was a trustee; however the Court noted, they could, naturally expect that the trustees would act (and did act) so that the benefits of the use of the funds would be secured without the impost of the highest personal tax rate.

The Court did find another purpose of the arrangements (the protection of assets from professional claims). However, that was not seen as the sole or dominant purpose because of the protection already in place through the combination of the accident compensation scheme and insurance cover. That was demonstrated by Mr Penny’s preparedness to borrow money back (never having left his hands) regardless of the supposed risk to him of claims by patients. Their Honours could also infer a genuine desire to build up assets for the benefit of the family in both cases. The tax advantage was, objectively one of the principal purposes and effects of each arrangement. The taxation advantage produced by the fixing of the salaries at low levels could be seen as the predominant purpose.

In response to a submission for the taxpayers that it was considered to be revolutionary, their Honours referred to the decision of Peate v Commissioner of Inland Revenue (1962-1964) 111 CLR 443 (HCA). Peate’s case
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involved incorporation and the use of family trusts by medical professionals and was held to be tax avoidance in both the High Court of Australia and the Privy Council. It was observed that it was not the novelty of doctors trading through corporate structures in the 1950s which caused what they did to be regarded as tax avoidance but, rather, the way in which they used those structures to obtain tax advantages, in particular by the fixing of the salary levels.

The Supreme Court accepted the taxpayers’ contention that there was no concept of a commercially realistic salary to be found in the ITA and that it does not require that an employee be remunerated on such a basis. However, the Court stated that what the Act does require of taxpayers, is that they should not structure their transactions with a more than merely incidental purpose of obtaining a tax advantage unless that advantage was in the contemplation of Parliament, such an example being found in the setting up of Portfolio Investment Entities. It is appropriate for the CIR to examine whether a salary has been set at a certain level on a commercial basis or for family reasons in which the tax consequences played no more than an incidental role. If the salary is not commercially realistic or, objectively, is not motivated by a legitimate (non-tax driven) reason, it will be open to the CIR to assert that it was, or was part of, a tax avoidance arrangement.

(b) Revenue alert

The CIR has issued a revenue alert RA 11/02 updating his view regarding the diversion of personal services income by structuring activities through an associated entity such as a company or trading trust. The main conclusions reached by the CIR are:

(a) The use of a structure such as a company or trust does not, of itself, give rise to revenue concerns. However, it does provide opportunities for the diversion of income.

(b) Whether or not such a diversion of income is legitimate requires a focus on whether the individual controller of the structure is adequately compensated for his or her skills and exertion. If the person is not adequately compensated, whether there are any valid commercial reasons for the low level of remuneration. Such reasons could include, for example, low business profitability or the need to retain profits in the business for future use.

The full text of the revenue alert can be found in TIB vol 23:8 (October 2011) at 4-7.

(3) White v Commissioner of Inland Revenue (2010) 24 NZTC 24,600 (HC)

In arriving at his decision in this case, Heath J distinguished the Court of Appeal case Penny (see above). The decision provides useful guidance regarding the practical application of Penny and the meaning of the closing comments of Randerson J in that case.

The High Court has overturned the TRA’s finding in TRA Case Z24 (2010) 24 NZTC 14,354 that an arrangement whereby the taxpayer, an anaesthetist who had incorporated a company to employ her, in respect of her private work, and to lease two avocado orchards and into which she paid all her private practice income, was a tax avoidance arrangement.

The orchards ran at a loss during the 2003 and 2004 tax years. Those losses were offset against the company’s income which was derived principally from the taxpayer’s personal effort. The taxpayer received no salary from the company for her services during those years and, as a consequence, she paid no tax for the relevant period. The CIR reassessed the taxpayer on the basis that the transactions in that period represented an arrangement that was void in terms of s BG 1. The taxpayer contended that she took a legitimate advantage of a provision entitling her to use a company structure in the way she did and that the Act allows individual taxpayers to establish closely held companies, by which they may be employed. The taxpayer contended that she did not declare a salary because the company had no money to pay.

After discussing Westpac, Ben Nevis, Glenharrow and Challenge Corporation v Commissioner of Inland Revenue [1986] 2 NZLR 513 (CA) Heath J said:

“… it follows that evidence of a subjective nature from the taxpayer and others may assist the Court in determining issues of avoidance. However, its use must be restricted to providing the context in which the arrangement was brought into being, in order to assist the Court to understand any genuine commercial arrangements involved.”
Heath J noted that the companies operated by the taxpayers in *Penny* had sufficient monies to pay salaries. That was not the position in this case. The taxpayer, as in *Penny*, also claimed that the possibility of exposure to litigation not covered by accident compensation legislation as the reason for the new financial structure. Citing *Ben Nevis*, Heath J considered it was necessary to look at the nature of the alleged arrangement and how it was carried into effect to determine whether its purpose or effect was to obtain an impermissible tax advantage.

Heath J found that, at the time the arrangements were entered into, the taxpayer did not expect there would be financial losses caused from the business activities. He further stated:

"... the reason that no money was available for Wharfedale [the company] to pay a salary to Dr White was because income had to be diverted to pay real (not contrived) debts. To adopt Woodhouse P’s comments in Challenge Corporation Ltd v Commissioner of Inland Revenue, Dr White formed and used a closely held company to obtain a tax advantage in a manner that was not inconsistent with the purpose for which the use of such a company was allowed. In arranging her affairs in that way, Dr White did nothing more than obtain the tax advantage that Parliament intended would follow to someone in her position."

Heath J went on to say that:

"The 'close company' regime specifically allows small family companies and their shareholders to account for the tax payable on the salary of a shareholder-employee under the provisional tax regime, rather than the PAYE system. The ability of a shareholder-employee to defer receipt of salary until the end of the tax year necessarily means there may be some circumstances in which it will be necessary, in fragile financial circumstances, for the working shareholder to donate his or her time, if funds are not available to pay proper remuneration."

It was considered that the Court of Appeal in *Penny* had accepted that a company and trust could be used in cases in such similar fact circumstances. *Penny* could be distinguished because this was not a case where a reduced salary was deliberately paid. A salary was not paid to the taxpayer because the company lacked the funds. Heath J stated:

"In my view, the possibility of unexpected losses that could result in salaries not being paid is expressly contemplated by the ability to use closely held companies to employ individual taxpayers on a provisional basis. Additionally, the evidence in this case was that Dr White did continue to pay provisional tax on the basis of income actually received from source. There is not evidence that Dr White would, inevitably, have received no or a minimal salary from the company in the relevant tax years."

The taxpayer’s arrangement was considered to be, (using the words of Ellen France J in *Penny*) “acceptable business practice and the opposite of artifice or contrivance”. Heath J cited the Court of Appeal in *Grieve v Commissioner of Inland Revenue* [1984] 1 NZLR 101, (1984) 6 NZTC 61,682, (1983) 6 TRNZ 461 (CA):

"It is not for the Courts or the Commissioner to confine the recognition of businesses to those that are always profitable or to do so only as long as they operate at a profit."

It was considered that, although the comments above were made in the context of what constituted “business”, it also gave an insight into the scheme and purpose of the ITA.

Heath J concluded that, at the time the arrangements were put in place, there was a realistic expectation of sufficient profit to pay the taxpayer a salary from which she would pay tax and that the main factor that contributed to the company making the losses was not foreseeable. This was supported by the taxpayer continuing to pay provisional tax on the pre-existing basis. It was a “permissible” tax advantage. The fact that the company happened to make a loss does not result in what would otherwise be an acceptable business arrangement being characterised as artificial or a contrivance: He stated:

“While the effect of the arrangement was (for unseen reasons) to negate the need for Dr White to pay income tax, the purpose was not to obtain an impermissible tax advantage. In my view, the purpose or effect of the arrangement was not to avoid payment of tax, having regard to the way in which the authorities have defined the words “purpose or effect”, as a composite phrase."
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Even if that conclusion is wrong, I consider that purpose or effect was “merely incidental” and therefore falls outside the scope of the definition of tax avoidance.”

(4) Alesco New Zealand Ltd v Commissioner of Inland Revenue (No 2) [2011] NZHC 1750

In 2002, the Australian listed company, Alesco Corporation Ltd (Alesco Corporation) raised around $85 million through debt and equity financing to enable its nominated purchaser, Alesco New Zealand (the taxpayer) to purchase two New Zealand businesses. With a view to securing the most tax effective means of financing the transactions and following receipt from its tax advisers Alesco Corporation used a form of zero coupon optional convertible notes (OCNs) to record payments amounting to $78 million to the taxpayer. The OCNs were interest free and at maturity could be converted into ordinary shares in the taxpayer or be redeemed for cash at an amount equivalent to the issue price.

Under the provisions of Determination G22, each OCN contained debt and equity components which Alesco Corporation was advised would allow the taxpayer to claim interest deductions in accordance with the methodology set out in the determination. Note that the arrangement pre-dated the release of Determination G22A which prohibits this treatment where the issuer and subscriber are members of the same wholly-owned group of companies.

The CIR disallowed the interest deductions and loss offsets claimed by the taxpayer on the grounds that it was a tax avoidance arrangement. Heath J dismissed the taxpayer’s challenges finding the OCNs to be nothing more than a means of obtaining tax benefits. His Honour concluded:

(a) **Artificiality** - There was no commercial purpose served by the taxpayer providing an option for Alesco Corporation to convert the debt to shares; There was no negotiation between the parties as there would be in an arm’s length transaction. Rather, the terms were crafted to secure the tax advantages and were therefore artificial.

(b) **Economic cost** – There was no economic cost incurred by the taxpayer. There was no commercial reason for a wholly owned subsidiary to issue an OCN to its parent company at par.

(c) The option element had no practical purpose or value because Alesco Corporation already owned the taxpayer.

(d) **The deductions claimed were not within parliamentary contemplation** – There was an absence of any match between expenditure incurred and income to be returned.

**TaxNote:** This decision has been appealed. The appeal may be heard by the Court of Appeal sometime in August or September 2012. There are similar financing structures used by 15 other taxpayers who have challenged the CIR’s decision to treat the arrangements as tax avoidance arrangements. The total amount in dispute in all these cases is said to be over $300 million. Agreement has been reached between some of the taxpayers and the CIR whereby the parties have undertaken to be bound by the ultimate outcome of the Alesco litigation after the appeal processes have been exhausted. See Telstra New Zealand Holdings Ltd v Commissioner of Inland Revenue [2012] NZHC 101.

**TaxNote:** In late 2011, Inland Revenue released Draft Interpretation Statement INS0121: Tax Avoidance and the Interpretation of Sections BG 1 and GA 1 of the Income Tax Act 2007, which sets out the CIR’s view of the correct approach when considering the application of s BG 1 and the adjustment power in s GA 1. The statement discusses:

• Issues relating to “arrangement”;
• The statutory definitions relating to tax avoidance;
• The Parliamentary contemplation test from Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue [2008] NZSC 115;
• Factual features that might indicate tax avoidance;
• The “merely incidental” test; and
• The adjustment power in s GA 1.
The draft interpretation statement also contains comments on some previous judicial approaches and other related avoidance issues. The draft interpretation statement has been released for comment and it is not yet known when it will be finalised or what changes will be made as a result of the consultation.

### 80.50 Other cases

The decision of the Supreme Court in *Ben Nevis* [see 80.45] has rendered many of the previous cases on the application of the general tax avoidance provision superfluous to an examination of the current state of the law on the matter. This view was expounded in the case of *Westpac Banking Corporation* [see 80.45]. Cases post-dating *Ben Nevis* provide guidance on the practical application of the principles laid down in that case. Cases on specific anti-avoidance provisions continue to have some relevance.

1. **Use of LAQC for home ownership**


   Mrs B settled a family trust. Mrs B and her accountant were the trustees. Mrs B and her daughter were the discretionary beneficiaries. An LAQC was incorporated with Mrs B being the sole shareholder and her accountant being the sole director. Mrs B borrowed money from the Public Trust, which she on-lent along with other money to the family trust. The trust then provided an interest-bearing loan to the LAQC. The LAQC used the funds to acquire a residential property. The borrowings from the Public Trust were secured by way of a mortgage granted by the LAQC. The trust entered into a tenancy agreement with Mrs B. Mrs B paid $300 per week to the Public Trust in respect of her borrowings. The LAQC treated this as rental paid to it. The LAQC returned tax losses for the rental activity. These losses were attributed to Mrs B which reduced her tax liability. Judge Barber stated that the *Ben Nevis* decision constitutes a comprehensive statement of law of income tax avoidance in New Zealand. His Honour went on to determine that the arrangement entered into by Mrs B was not of a kind that would conceivably have been contemplated by Parliament when enacting the LAQC and deduction provisions. He found that the arrangement was artificial and contrived, allowed for deductions that would otherwise be private or domestic and therefore non deductible, and constituted a tax avoidance arrangement that was void.

2. **Use of company structure to divert personal exertion income**

   *Russell v Commissioner of Inland Revenue* (2010) 24 NZTC 24,463 (HC)

   The taxpayer appealed the TRA’s decision in *TRA Case Z19* (2009) 24 NZTC 14,217 finding that he was involved in a tax avoidance arrangement and that he obtained a tax advantage from that arrangement. The taxpayer was assessed with the income of a partnership that he controlled. The partnership was involved in a tax avoidance arrangement based on a template. Under the template arrangement, the partnership would receive consultancy fees from trading companies in the template group. The income of the companies in the group would be offset against losses of loss companies in the group. Those loss companies would be acquired by the taxpayer when insolvent and, after obtaining control, the taxpayer purported to trade the insolvent companies under agency and management agreements. The taxpayer’s personal exertion income was treated as income of the partnership diverted to the loss companies under the agency and management agreements. The taxpayer’s personal exertion income was treated as income of the partnership diverted to the loss companies under the agency and management agreements. Surpluses or net profits from those untaxed monies were forwarded daily from that partnership to the group finance companies. All the entities were controlled by the taxpayer, who directed the use of those funds. The finance companies acted as bankers to the taxpayer’s template group of companies and other entities; and all cash in the group was used at the taxpayer’s direction, including the business income of the partnership. On a yearly basis, there were changes to the companies which made up the partnership, and the loss companies were replaced when losses were extinguished.

   The taxpayer’s appeal was dismissed. Wylie J found that the taxpayer structured the arrangement in order to gain a tax advantage in an artificial and contrived way. He set up a complex corporate structure so as to divert income from his personal exertions, whether generated either directly or indirectly through his control of the employees, into companies who were able to access the losses in the unrelated companies to avoid paying income tax. Overall, the most relevant factor was that the taxpayer controlled everything. Although the taxpayer did not directly receive any of the income generated by the arrangement, it was considered that he...
Avoidance was affected by the arrangement because he obtained a tax advantage by not paying tax on the income he would have earned but for the arrangement. It was concluded that the steps taken by the taxpayer to divert the income generated by his personal exertions into the CM partnership was not within the contemplation of Parliament. Parliament’s intention being that individuals should pay income tax at the appropriate rate on their net income.

(3) Use of loans rather than profit distributions

Krukziener v Commissioner of Inland Revenue HC Auckland CIV-2010-404-728, 17 September 2010

The case concerned a property developer who operated his business through a series of trading trusts. As a development project was completed, the profits were distributed to the next trust which, by then, had commenced another development and was in a start-up loss position. In all, over 80 development projects were undertaken in this manner. Rather than take a salary, the taxpayer funded his living expenses from interest-free loans made to him by the various entities in the “group”. Effectively, the businesses were paying interest on borrowings to fund the taxpayer’s interest-free loans which totalled over $5 million over a nine-year period.

The matters considered by the Court were:

(a) Was there an arrangement and, if there was, was it tax avoidance or was the tax advantage merely incidental?
(b) Were some years time barred as against the CIR?
(c) Were penalties correctly imposed?

In answer to the first question, the Court found that there was a plan that the taxpayer would not repay any loan unless there was a capital distribution available from which to make the repayment, thus ensuring that no taxable income was derived by the taxpayer. Her Honour said:

“Where the proprietor of a business has expended time and effort on a project, and incurred debt waiting for the project to be completed, and the project is completed at a profit, there would seem to be no legitimate reason for some of that profit not to be distributed. The need of the next project for funds does not preclude such distribution since it is always open to the proprietor of the business to advance funds for the next project. In the circumstances of this case, therefore, I do not accept that the level of income provided to Mr Krukziener over such a long period can be regarded as legitimate.”

Her Honour found the arrangement to be tax avoidance.

In answer to the second question, the Court found that the nature of the income was loans from the trusts. As these had not been disclosed in a return of income, the time bar did not apply [TAA, s 108(2)].

On the matter of shortfall penalties, the Court found that tax benefits were the dominant purpose of the arrangement and that the taxpayer had taken an abusive tax position.

80.60 Specific income tax anti-avoidance provisions

Various specific anti-avoidance sections exist in the legislation, as follows:

(a) Section GB 1 allows the CIR to tax the proceeds from the sale of shares in a dividend stripping arrangement [see 80.22];
(b) Section GB 2 allows the CIR to arbitrarily calculate income for businesses controlled by non-residents as a percentage of either receipts or payments [see 1000 NON-RESIDENTS AND ABSENTEES];
(c) Section GB 3 allows the CIR to determine that the required shareholder continuity provisions have not been met in the carry forward of losses by a company [see 940 LOSSES];
(d) Section GB 4 allows the CIR to strike down contrived shareholder commonality percentages brought about to allow offset of losses within companies in a group [see 940 LOSSES];
(e) Section GB 5 allows the CIR to strike down the continuity provisions where shares are held in trust and there are changes to the beneficiaries in the trust brought about to defeat the application of the shareholder continuity provisions [see 940 LOSSES];

(f) Section GB 6 allows the CIR to strike down contrived shareholdings intended to defeat the shareholder requirements for qualifying companies [see 1160 QUALIFYING COMPANIES];

(g) Section GB 7 allows the CIR to count the shareholdings of nominees which are intended to defeat the application of the controlled foreign companies regime [see 850 INTERNATIONAL TAX REGIME];

(h) Section GB 8 allows the CIR to strike down arrangements intended to defeat the application of the controlled foreign companies attributed repatriation provisions [see 850 INTERNATIONAL TAX REGIME];

(i) Sections GB 9 to GB 14 allow the CIR to defeat variations in control and income interests in foreign companies [see 850 INTERNATIONAL TAX REGIME];

(j) Sections GB 15 and GB 16 allow the CIR to defeat arrangements for elections made for attributed foreign income and foreign investment fund income [see 850 INTERNATIONAL TAX REGIME];

(k) Sections GB 17 to GB 19 allow the CIR to defeat arrangements in acquiring film rights [see 460 FILM INDUSTRY];

(l) Section GB 20 allows the CIR to defeat arrangements in petroleum mining [see 980 MINING COMPANIES AND OPERATORS];

(m) Section GB 21 allows the CIR to defeat arrangements involving the financial arrangements rules [see 470 FINANCIAL ARRANGEMENTS];

(n) Section GB 22, allows the CIR to see through trust arrangements where persons other than beneficiaries derive a benefit from the trust [see 1420 TRUSTS AND ESTATES];

(o) Sections GB 23 to GB 25 which allow the CIR to disallow the payment of excessive remuneration to associates [see 170 COMPANIES AND 270 DIVIDENDS];

(p) Section GB 26 allows the CIR to defeat arrangements regarding the repatriation of commercial bills;

(q) Sections GB 27 to GB 29 which, in defined circumstances, attribute income from personal services to the person who provided the effort [see 740 INCOME ASSIGNED OR ALIENATED];

(r) Section GB 30 allows the CIR to treat amounts as being consideration under a restrictive covenant;

(s) Section GB 31 allows the CIR to look through arrangements whereby a motor car which is provided as a fringe benefit is acquired from an associated person, and to look through any other arrangements to defeat the fringe benefit tax regime [see 540 FRINGE BENEFIT TAX];

(t) Section GB 32 allows the CIR to deem fringe benefits provided to associates of employees to have been enjoyed or received by the employee [see 540 FRINGE BENEFIT TAX];

(u) Section GB 33 enables the CIR to disallow a depreciation deduction outside the intended provisions [see 250 DEPRECIATION];

(v) Sections GB 34 to GB 41 allow the CIR to strike down arrangements to defeat the imputation regime, the dividend withholding payment regime and the branch equivalent payment account regime [see 670 IMPUTATION];

(w) Sections GB 42 and GB 43 allow the CIR to counter arrangements to defeat the Maori Authority credit account provisions;

(x) Allows the CIR to strike down any arrangements to defeat the family support provisions [see 420 FAMILY ASSISTANCE];

(y) Sections GB 45 to GB 48 allow the CIR to counter arrangements involving money not at risk such as limited-recourse or non-recourse loans;
(z) Section GB 49 allows the CIR to strike down arrangements involving returning share transfers [see 1340 SHARE SALES]; and

(za) Section GB 50 allows the CIR to substitute a market value amount for the consideration under an arrangement entered into by a partner in a partnership.
Bad Debts and Bad Debts Reserves

Chapter 90

Bad Debts and Bad Debts Reserves

90.10 Statutory provisions [ss CG 3, DB 31]

A deduction for a bad debt is allowed only to the extent that the debt has been written off as bad in the income year [s DB 31]. In order to be deductible, a debt must therefore be bad [see 90.20] and it must be written off in the income year in which the deduction is claimed [see 90.30].

Any bad debts written off which are subsequently recovered must be included in assessable income in the year in which they are recovered [s CG 3]. The taxpayer must keep the necessary records to support the write-off [see 90.30]. If the bad debt relates to an amount owing under a financial arrangement, a deduction is allowed only if certain additional requirements are met [see 90.50].

90.20 When debts are bad

It is a question of fact whether or not a debt is bad and it depends in each case on the prospects of recovery. It is not possible to formulate any rules by which it may be determined as a matter of law whether a debt is a bad debt. It has always been contended by Inland Revenue that to obtain a deduction the debt must be bad and must be actually written off. Inland Revenue takes a practical approach to the determination of the stage when a debt becomes bad, but is not prepared to accept a practice of writing-off provisions or percentages of good debts almost immediately they arise and of allocating block percentages of debts as bad throughout various areas of the country without any regard to the facts or probabilities of the case.

It is not necessary to exhaust all available legal remedies before deciding whether a debt is wholly or partly bad, but intrinsically there must be no reasonable or probable expectation of recovery. The debt must be genuinely irrecoverable at the point where the decision is made to write it off. On being satisfied this is the case and a bona fide decision is made and the debt is wholly or partly written off, the position is accepted by Inland Revenue.

In Budget Rent A Car Ltd v Commissioner of Inland Revenue (1995) 17 NZTC 12,263 (HC), a taxpayer company was allowed to write off a bad debt of $2 million even though it had entered into a covenant not to sue the debtor for the amount owing.

In TRA Case S73 (1996) 17 NZTC 7,454, a letter to the CIR advising him that a debt had been written off was accepted as evidence that a debt was bad and had been written off. Judge Willy held (at 7,458) “[t]hat letter is as good an item of evidence as an entry in the taxpayer’s books of account”.

What constitutes evidence that a debt has been written off will depend on the nature of the accounting records maintained by the particular taxpayer.
90.30  Public ruling on bad debts [s DB 31]

The CIR’s policy on writing-off bad debts for income tax and GST purposes is set out in public ruling BR Pub 05/01 [see TIB vol 17:2 (March 2005) at 5-20]. The ruling applies from 1 April 2004 for an indefinite period.

The ruling permits an income tax deduction under s DB 31(1) and an input tax deduction under s 26(1)(c) of the GSTA for a bad debt if the following conditions are met:

(a) An existing debt is owing to the taxpayer;
(b) The debt is adjudged as “bad” when a reasonably prudent commercial person would conclude that there is no reasonable likelihood that the debt will be paid; and
(c) The bad debt is “written off” in accordance with the accounting and record keeping systems maintained by the taxpayer (see below for details).

The key elements of the ruling are that the debt must be both bad and written off before an income tax or GST deduction can be claimed.

(1) Debt must be bad

Whether a debt (or part of a debt) is bad is a question to be determined objectively, rather than by the subjective opinion of any particular individual. The test to be used in deciding whether a debt is bad, is whether a reasonably prudent commercial person would conclude that there is no reasonable likelihood that the debt will be paid. This objective test was outlined by Tompkins J in the High Court decision of Budget Rent A Car Ltd v Commissioner of Inland Revenue (1995) 17 NZTC 12,263 (HC).

At the time of deciding whether a debt is bad, a person will need to have sufficient information to enable a reasonably prudent commercial person to form the view that there is no reasonable likelihood that the debt will be paid. The debt must be more than doubtful. A debt cannot be bad if there is a real and continuing dispute as to whether or not the debt is payable. The facts needing to be gathered depend on the circumstances. While no factor is decisive in itself, factors that are likely to be relevant in considering whether a debt is bad are:

(a) The length of time a debt is outstanding — the longer a debt is outstanding the more likely it is that a reasonably prudent commercial person would consider the debt to be bad;
(b) The efforts that a creditor has taken to collect a debt — the greater the extent to which a person has tried (unsuccessfully) to collect a debt, the more likely it is that a reasonably prudent business person would consider the debt to be bad;
(c) Other information obtained by a creditor — a creditor may have obtained particular information about a debtor (eg through business or personal networks) that would be a factor in leading a reasonably prudent commercial person to conclude that a debt is bad. For example, a creditor may know that the debtor is in financial difficulties and has defaulted on debts owed to other creditors;
(d) A debt may be considered bad if the debtor has died leaving no, or insufficient, assets out of which the debt may be satisfied;
(e) The debtor cannot be traced and the creditor has been unable to ascertain the existence of, or whereabouts of, any assets against which action could be taken;
(f) Where the debt has become statute-barred and the debtor is relying on this defence (or it is reasonable to assume that the debtor will do so) for non-payment;
(g) If the debtor is a company, it is in liquidation or receivership and there are insufficient funds to pay the whole debt, or the part claimed as a bad debt.

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

Taxpayers should document and retain evidence to show that their decision to treat a debt as bad was reasonable. Documentation may include noting down the information from which the decision was made that the debt was bad, and keeping copies of any correspondence relating to the debt.
The amount of information required to decide whether a debt is bad depends on the particular circumstances of each case. The test is whether the taxpayer has sufficient information to reasonably draw the conclusion that there is no reasonable likelihood that the debt will be paid, even if further or any recovery action were to be taken.

A debt may be bad even though the taxpayer is still taking action to recover it. Recovery action may be taken for a number of reasons, even though a reasonably prudent commercial person would consider there is no reasonable likelihood that the debt will be paid. It is not essential that recovery action be taken before a decision is made that a debt is bad.

Taxpayers cannot claim an income tax or GST deduction for a provision for doubtful debts. A provision for doubtful debts is an estimate of the amount that will become bad debts in the future. Bad debts are individually identifiable debts that are unlikely to be recovered.

If a creditor has a reasonable expectation that only a part of a debt will be recovered, the part that is unlikely to be recovered is a bad debt.

Example 1:
A supplier has supplied goods on credit to Mr B. Mr B owes the supplier $2,000 for the goods. The supplier knows that Mr B has left town, and that mail addressed to him is returned marked "Gone no address". In this case it is reasonable to assume that the debt will not be recovered. The money owed by Mr B is a bad debt.

Example 2:
A debtor of Mr F is a company in liquidation. Mr F has given the liquidator notice of a debt of $10,000 owed for goods and services supplied. Mr F is an unsecured creditor. The liquidator has held a meeting of creditors. Mr F attended the meeting and received formal notice of the outcome of the meeting. The liquidator has stated that unsecured creditors will probably receive about 45 or 50 cents in the dollar. It is reasonable for Mr F to assume that $5,000 of the total debt is bad. He is entitled to write off that part of the debt that is bad in the income year in which he received the formal notice, and to claim a deduction for income tax and GST purposes.

(2) Debt must be written off
Writing-off the bad debt is important because this will fix the time at which the deduction can be made. There is no requirement that a debt be written off in the year it becomes bad: *Budget Rent A Car Ltd v Commissioner of Inland Revenue* (1995) 17 NZTC 12,263 (HC).

Taxpayers must be able to clearly show that the debt has actually been written off as bad. The bad debt must be “written off” in accordance with the accounting and record keeping systems maintained by the taxpayer. Write-off action would involve, at a minimum, the following action:

(a) By a large corporate or business taxpayer with a computerised bad debts system: an authorised person making the appropriate entry recording the debt as written-off.

(b) By a company (other than the above): an executive or other responsible officer of the company with the authority to do so, making the appropriate bookkeeping entries in the books of account recording the debt as written off.

(c) By a taxpayer (other than a company) with double-entry accounts: an authorised person making the appropriate bookkeeping entries in the books of account of the business recording the debt as written off.

(d) By an unincorporated sole trader or small unincorporated business taxpayer without double-entry accounts: the taxpayer noting, in the bookkeeping records setting out the amount owed by the bad debtor, that the debt has been written off, and the date of the writing off.

The necessary writing off must take place before the end of the income year or GST taxable period in which the bad debt deduction is claimed. Writing-off a bad debt cannot be backdated.

The business records kept by the taxpayer must comply with the requirements of s 22 of the TAA and s 75 of the GSTA.

If a person keeps double-entry accounting records, the bad debt must be struck out of the records on which the double-entry accounts are based. If a debtors ledger is maintained, the writing-off can be clearly shown...
by the authorised persons having made appropriate bookkeeping entries in the debtors ledger. No matter what processes are followed in the course of preparing a person’s double-entry accounts, it is the completion of the appropriate authorised entries actually writing-off a debt which has been judged as bad in accordance with the tests already outlined that is essential to deductibility.

Where a taxpayer does not keep double-entry accounting records and/or does not keep a debtors ledger, the taxpayer must write the debt off according to the form of records used. Whatever the form of records used, those showing the amount owed by the bad debtor must clearly record that the creditor, having made the decision that the debt is bad, has written the debt off accordingly.

Examples of bad debts accepted by the CIR as having been written off are:

(a) If a taxpayer’s only records of debts are copies of invoices issued, placing the invoice in a “bad debts” file and indicating on the invoice whether all or part of the invoiced amount is bad and the date.

(b) If a taxpayer’s only records of debts are copies of invoices and copies of statements of account issued from a duplicate account book, marking the copy of the final statement sent out “bad debt — written off” (noting the amount of the debt that is bad and the date) is sufficient. It would also be sufficient for the taxpayer to place the relevant invoice in a “bad debts” file indicating on the invoice whether all or part of the invoiced amount is bad and the date this was done.

90.40 Debts owing within a group of companies [s DB 31(5)]

A limited deduction for a bad debt is allowed when the taxpayer is a company (referred to as company A) and the debt is owed by another company (referred to as company B) and the amount giving rise to the debt is taken into account in calculating a loss incurred by company B or any other company funded (directly or indirectly) by company B (referred to as company C) and the loss has already been included as a deduction to company A (or any other company which is, at any time in the income year in which company B or company C has the net loss, in the same group of companies as company A).

The deduction is limited to the difference between the debt written off and the amount of the debt included in the loss of the other company that has been offset in the group. This provision prevents a double deduction for the write-off of a bad debt that could, for example, be obtained by taking a bad debt deduction in a subsidiary company and offsetting any resulting loss under the loss grouping rules.

Note: Section DB 31 applies only when the loss is incurred before the income year in which the bad debt is written off. The circumstance when the loss arises in the same income year as the bad debt deduction is covered in s IC 12, which prevents the loss offset to the extent of the bad debt deduction.

90.50 Bad debts under financial arrangements [s DB 31(2)-(5)]

When a bad debt relates to an amount owing under a financial arrangement, a deduction is allowed to the extent that the debt is written off as bad in the income year [see 90.10, 90.30] and if the following additional requirements are met.

A person who derives assessable income from a financial arrangement to which the financial arrangements rules [as defined in s EW 1(2)] apply is allowed a deduction for an amount owing under the financial arrangement if the amount is attributable to that income, and s DB 31(5) [see 90.30] does not apply. A deduction is available for the amount owing under a financial arrangement (ie the capital or principal amount), if the debt is written off as bad in the income year and the person carries on a business for the purpose of deriving assessable income that includes dealing in or holding financial arrangements that are the same as the financial arrangement in question. However, a bad debt deduction is not available for the principal amount when the parties are associated persons.

Trade debts that are financial arrangements will be deductible to the extent that the amount is written off as bad, the financial arrangement is an agreement for the sale and purchase of property or services and the person is in the business of dealing in the property or services that is the subject of the financial arrangement.

A base price adjustment under the financial arrangements rules does not arise merely because a bad debt is written off by the lender.
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For further discussion on the deductibility of bad debts under the financial arrangement rules, see the commentary on public ruling BR Pub 05/01 [see TIB vol 17:2 (March 2005) at 15-20].

90.60  **Trade credits** [ss DB 31(1) and (4), EZ 40(2)(b)]
Short-term agreements for the sale and purchase of property are excepted financial arrangements that are not subject to the financial arrangement rules, unless an election is made under s EW 8. Trade debts that are not financial arrangements are subject to general rule in s DB 31(1).
There is no limitation on the deduction for a loss of capital when the trade debt is a financial arrangement and the person carries on the business of dealing in goods and services for which the trade credit is a debt.

90.70  **Bad debts reserve is not deductible** [s DB 31(1)(a)]
A bad debts reserve (provision for doubtful debts) is an amount set aside to account for bad debts, without actually writing-off the bad debts. A reserve for bad debts is not allowed as a deduction.

90.80  **Security payments received** [ss DB 14, DB 15, EW 51]
A security payment is money received by the holder of a security arrangement that relates to a loss suffered for the failure of performance of the arrangement secured. The value of the security payment is assessable. A taxpayer may, therefore, receive a security payment for a loss. However, the loss incurred by the holder of the security arrangement may not be deductible.
When a person receives a security payment to reduce a loss which is not allowable, a deduction of the loss is allowed under s DB 14 but limited to the amount of the security payment received in terms of s EW 51. This offset ensures that no assessable income arises because of receipt of a security payment when the loss reimbursed was not deductible.
A security payment arises when money is paid to the holder of a security arrangement to cover a loss incurred through failure of the secured arrangement’s performance. The payment is taken into account in determining the holder’s income. Expenditure or loss by the person who stood surety is not deductible under s DB 15 if it was due to the actions of the surety person or to an event’s occurrence (or failure to occur) that was actually or potentially subject to the influence of the surety person (or any person who was an associated person during the term of the security arrangement). Alternatively, the loss may not be deductible if the security holder is not in the business of holding or dealing in financial arrangements.
A “security arrangement” means a financial arrangement that secures a party against another person failing to perform the person’s obligations under a secured arrangement. A “secured arrangement” means an arrangement whose non-performance is secured against by a financial arrangement [s YA 1].

90.90  **Bad debts owed to estates** [s DB 32]
A deduction is allowed when a trustee of a deceased person’s estate writes off some or all of a debt owing to the person at their date of death if:
(a) The debt relates to assessable income of the deceased person or the trustee of their estate; and
(b) The debt was written off because it was not recoverable.
The deduction is allowed for the amount of debt written as follows:
(a) First, against trustee income, to the extent of that income for the income year;
(b) Secondly, against beneficiary income, to the extent of assessable income derived in he income year by or in trust for the beneficiary, and to the extent that the amount is chargeable against the capital of the beneficiary; and
(c) Thirdly, against trustee income or income of a beneficiary in the next tax year, as in (a) and (b), and so on.

90.100  **Principles established from case law**
In TRA Case N69 (1991) 13 NZTC 3,541, TRA Case P53 (1992) 14 NZTC 4,370, and TRA Case T48 (1998) 18 NZTC 8,325, the following concepts have been established:
Bad Debts and Bad Debts Reserves

(a) An objective test should be made to indicate whether a reasonable and prudent business person, on the balance of probability, would consider a debt unlikely to be recovered. This does not preclude the taxpayer from continuing to hope for and seek recovery. It is not a criteria that the debt is unlikely to be recovered within 12 months;

(b) The decision to write off the bad debt must be made by an authorised person within the organisation;

(c) The writing-off requires both a business decision and also appropriate writing-off in the books of account or accounting procedures. There is no single formula for the mechanics to write off bad debts. There is no legal requirement for a journal to be maintained; and

(d) The decision and the recording must be made in the financial year. It is too late if it takes place after the end of the financial year.
## Chapter 100

### Bankruptcy

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#### 100.10 Profits subsequent to adjudication [s CW 38]

On adjudication, the property of a bankrupt passes to the Official Assignee, who is by law obliged to realise the assets of the bankrupt and apply the moneys received on registration in the manner set forth in the Insolvency Act 1967. The definition of “person” in the ITA 2004 only applies for the purposes of the income equalisation schemes. Accordingly, the new definition of “person” is now found in s 29 of the Interpretation Act 1999 which states:

> “Person includes a corporation sole, a body corporate, and an unincorporated body;”

The Advisory Panel has determined that there is no change in outcome, and no unintended legislative change from the new definition. The new definition of person continues to have all the components of the former definition in the ITA 1994. The former definition of “person” in the ITA 1994 included “a local or public authority”. Accordingly, the Official Assignee is a “public authority”, which comes within the definition of a “person” in the ITA 2004.

Although s CW 38 exempts the income of any public authority, it does not extend to income received in trust. As the income of the Official Assignee is received in trust for the bankrupt person and creditors, the s CW 38 exemption does not apply. However, the Official Assignee can be regarded as an administrator. As the definition of “trustee” includes an executor or administrator the income derived in a bankrupt’s estate is taxed as a trust.

#### 100.20 Losses prior to adjudication

The Official Assignee who carries on a business formerly carried on by the bankrupt is a new taxpayer and consequently is not entitled to carry forward losses incurred by the bankrupt prior to adjudication. Any mortgagee who enters into possession of the bankrupt’s property and who carries on a farming or other business is accountable to the Official Assignee and is similarly unable to carry forward such losses. Where the Official Assignee exercises a right of disclaimer for a mortgaged property, and the property is taken over by the mortgagee, the latter assumes possession as owner.

The bankrupt person is also affected where a debt has been taken into account in arriving at a loss and the taxpayer’s liability for that debt has been remitted or cancelled. The loss to be carried forward is reduced by the amount remitted or cancelled. This precludes bankrupt persons who have entered into compositions with their creditors from setting-off or carrying forward any losses which are represented by cancelled debts. This may not arise where:

(a) The provable debts (or some of them) were non-business debts and, therefore, not related to losses in the business.

(b) The losses available prior to bankruptcy exceed the provable debts.

(c) The provable debts were on capital account.

(d) After discharge from bankruptcy the revenue debts were paid voluntarily. In this case the amounts paid are allowed as a deduction in the year in which payment is made.

See 470 FINANCIAL ARRANGEMENTS for commentary regarding the impact of bankruptcy on the base price adjustment calculation.
**100.30  Preferential claims — tax rankings** [TAA, ss 137, 170, 172]

Income tax is not a preferential claim in bankruptcy or company liquidations. In a liquidation Inland Revenue ranks as an unsecured creditor for income tax on income derived by the company prior to the date of liquidation. Unless the company is solvent, the liquidator may be unwise in paying the income tax immediately merely to avoid late payment penalties, as this would amount to undue preference to one particular creditor.

PAYE tax deductions and non-resident withholding tax deductions are deemed to be held in trust for the Crown. If they are kept separate or can be traced, they do not form part of the bankrupt’s estate. Unpaid deductions not kept separate constitute a charge on the property of the payer.

These amounts do not form part of the assets of the company or bankrupt person and are not available for payment of creditors. In a winding-up or bankruptcy the debt to the Crown ranks, in order of priority, immediately after preferential claims for wages and in priority to all other claims. Similarly, any Resident Withholding Tax withheld is held on trust for the Crown, is not available for the payment of creditors and constitutes a charge on the property of the bankrupt person.

Bankruptcy does not terminate the disputes procedure. Penal tax has been held to be a civil debt provable in bankruptcy and if bankruptcy is subsequent to the imposition of penal tax, Inland Revenue must comply with the Insolvency Act 1967 to recover: TRA Case H85 (1986) 8 NZTC 592.

**100.40 Special returns** [TAA, s 44]

The CIR is empowered to require a person who has become bankrupt to file a special return of income.

**100.50 Unpaid tax** [TAA, ss 177A, 177C, 177CA]

The likelihood that a taxpayer may become bankrupt is excluded from the definition of “serious hardship” for the purposes of the remission and relief powers of the CIR. Any outstanding tax that cannot be recovered must be written off by the CIR but may be reinstated if further funds become available. The write off provisions do not apply to tax or penalties for an abusive tax position or evasion.

Amounts outstanding under an instalment arrangement must be included in the CIR’s proof of debt.
Chapter 115

Binding Rulings

115.10 Types of binding rulings [TAA, ss 91A to 91J]

The CIR is able to make binding rulings on how it applies the taxation laws. The stated purpose of binding rulings is to provide taxpayers with certainty about the way the CIR applies taxation laws and to help them meet their obligations under those laws [TAA, s 91A]. The CIR can issue four types of binding rulings:

(a) Public rulings [see 115.40];
(b) Private rulings [see 115.50];
(c) Product rulings [see 115.60]; and
(d) Status rulings [see 115.70].

Taxpayers cannot apply for public rulings but they can suggest to the CIR any topics that may be appropriate for public rulings. Public and product rulings are available to the public, but private rulings are only available to those who applied for them. Before 1 April 1996 private rulings were only issued for arrangements not entered into as at the date of application. From 1 April 1996 the CIR may also issue private rulings on current and completed arrangements. Status rulings are rulings on how a law change affects a private or product ruling. The legislation dealing with binding rulings is contained in ss 91A to 91J of the TAA and the Tax Administration (Binding Rulings) Regulations 1999.

115.20 Scope of binding rulings [TAA, s 91C]

The CIR can make a binding ruling on any provision contained in:

(a) The Estate and Gift Duties Act 1968;
(b) The Gaming Duties Act 1971;
(c) The Goods and Services Tax Act 1985, except s 12 (imposition of GST on imports) and s 13 (goods liable to excise duty and supplied at “in bond” prices) of that Act;
(d) The Stamp and Cheque Duties Act 1971;
(e) The ITA 1994, except to the extent that the matter in question is or could be the subject of a determination of the CIR:
   (i) In relation to financial arrangements under ss 90 or 90AC of the TAA;
   (ii) In relation to the extent to which a financial arrangement under s 90A provides funds to a party to the arrangement;
   (iii) For determinations in relation to petroleum mining operations under s 91 of the TAA;
Binding Rulings

(iv) For determinations in relation to accrual expenditure under s EF 1(3) of the ITA 1994;
(v) For the setting of basic economic depreciation rates under s EG 4 of the ITA 1994, or for special or provisional economic depreciation rates under s EG 10 of the ITA 1994, or for higher maximum pooling values under s EG 11 of the ITA 1994, or (until the end of the 2001-2002 income year) for the deduction of the remaining adjusted tax value of property that can no longer be used under s EG 12 of the ITA 1994; and
(vi) For the calculation method of specified livestock costs under the national standard cost scheme under s EL 4 of the ITA 1994 or the standard values of non-specified livestock under s EL 9(3) of the ITA 1994.

(f) The ITA 2004, except to the extent that the matter is or could be the subject of a determination of the CIR:
   (i) In relation to a financial arrangement under ss 90 or 90AC of the TAA;
   (ii) In relation to the extent to which a financial arrangement provides funds to a party under the arrangement, under s 90A of the TAA;
   (iii) In relation to petroleum mining under s 91 of the TAA;
   (iv) In relation to livestock under ss 91AAD or 91AAE of the TAA;
   (v) In relation to depreciation under ss 91AAF to 91AAM TAA; or
   (vi) In relation to prepayments under s EA 3(8).

(g) The ITA 2007, except to the extent that the matter is or could be the subject of a determination of the CIR:
   (i) In relation to a financial arrangement under ss 90 or 90AC of the TAA;
   (ii) In relation to the extent to which a financial arrangement provides funds to a party under the arrangement, under s 90A of the TAA;
   (iii) In relation to petroleum mining under s 91 of the TAA;
   (iv) In relation to livestock under ss 91AAD or 91AAE of the TAA;
   (v) In relation to depreciation under ss 91AAF to 91AAM of the TAA; or
   (vi) In relation to prepayments under s EA 3(8) of the ITA 2007.

(h) Any Order in Council or regulation made under s 225 of the TAA or under any of the Acts listed above, except:
   (i) A provision that is or could be subject to a determination of the type listed under (e) or (f) above; or
   (ii) Section RD 24 of the ITA 2007.

The CIR can issue a status ruling on how a change in tax law will affect an existing ruling [TAA, s 91GB]. The CIR may also make a binding ruling on how the CIR will exercise his/her discretion when deciding whether to make a binding ruling. “Discretion” is defined to include the exercising of a power by the CIR, the forming of an opinion by the CIR, or the attaining by the CIR of a state of mind, in relation to a taxation law [TAA, s 91B]. A binding ruling cannot be made on any provision that authorises or requires the CIR to: impose or remit a penalty; inquire into the correctness of a return or other information supplied by any person; prosecute any person; or to recover a debt owing by any person [TAA, s 91C(3)]. The CIR may not make a binding ruling on:

(a) Whether a person meets the eligibility requirements for a research and development tax credit [s LH 3];
(b) Whether expenditure or depreciation is eligible expenditure for the purpose of calculating a research and development tax credit [s LH 4];
Whether an activity is a research and development activity for the purpose of a research and development tax credit [s LH 7; TAA s 91C(4)].

115.30 Applicants with outstanding debts [TAA, s 91J]

The CIR may refuse to issue a private, product, or status ruling to an applicant if the applicant has an outstanding debt (arising on or after 1 June 1999) that relates to an earlier binding ruling application.

An applicant has an outstanding debt if they have not paid the amount stated in an invoice issued by Inland Revenue within 60 days of the date of the invoice.

115.40 Public rulings [TAA, ss 91D, 91DA, 91DB, 91DC, 91DD, 91DE]

The CIR is able to issue a public ruling at any time on how a taxation law applies to a category of person and a type of arrangement. If a public ruling on a taxation law applies to a person in relation to an arrangement, and the person applies the taxation law in the way stated in the ruling, the CIR must apply the taxation law in accordance with the ruling.

A public ruling applies to a person and an arrangement only if all the following conditions are met:

(a) The taxation law is expressly referred to in the ruling;
(b) The arrangement is of the type specified in the ruling;
(c) The arrangement is entered into during the period or tax year for which the ruling applies, or in the case of a ruling issued for an indefinite period, on or after the date, or on or after the first day of the tax year, from which the ruling applies.

A binding ruling does not apply to a taxpayer if the taxpayer has issued the CIR with a NOPA to change the effect of the ruling previously applied by the taxpayer.

The CIR notifies the making of a public ruling by notice in a publication chosen by the CIR. The notice states the subject of the ruling and where a copy of the ruling can be obtained. The CIR must publish each public ruling, in full, in an Inland Revenue publication. It is the CIR’s practice to publish the full text of public rulings in the Tax Information Bulletin. In order to take effect, a public ruling must state:

(a) That it is a public ruling made under s 91D of the TAA;
(b) The taxation law or laws on which it rules;
(c) The arrangements to which the ruling applies;
(d) How the taxation law or laws apply to the arrangement; and
(e) The period or tax year for which the ruling applies, or in the case of a ruling issued for an indefinite period, the date or tax year from which the ruling applies.

The CIR can extend the period for which a public ruling applies by publishing a notice of extension. This notice must state:

(a) That it is an extension of a public ruling under s 91DD of the TAA;
(b) The original period or tax year for which the ruling applied; and
(c) The new period or tax year for which the ruling applies.

The CIR can withdraw a public ruling at any time by publishing a notice of withdrawal in a publication chosen by the CIR. The notice of withdrawal must state:

(a) That it is a withdrawal of a public ruling under s 91DE of the TAA;
(b) The ruling that is being withdrawn;
(c) The original period or tax year for which the ruling applied, or in the case of a ruling issued for an indefinite period, the original date or tax year from which the ruling applied; and
(d) The date of the withdrawal.

The effective date of the withdrawal is the date stated on the notice. It can be no earlier than the date the notice is published. In other words, a withdrawal cannot have effect retrospectively. Once a ruling is
withdrawn, it does not apply to any arrangement entered into after the date of withdrawal but it continues to apply to any arrangement entered into before the date of withdrawal for the remainder of the period or tax year specified in the ruling. If the ruling was issued for an indefinite period, the ruling continues to apply for three years after the date of withdrawal.

For a comprehensive list of the public rulings issued to date [see 3000 BINDING RULINGS].

115.50 Private rulings [TAA, ss 91E, 91EA, 91EB, 91EC, 91ED, 91EE, 91EF, 91EG, 91EH, 91EI, 91EJ]

Any person, either in their own right or on behalf of a person who is yet to come into legal existence, may apply to the CIR for a private ruling on how a taxation law applies, or would apply, to the person (or the prospective person) and to any arrangement (whether a single or recurring arrangement), and the CIR must make such a private ruling. Two or more persons may apply jointly, or a person may apply on behalf of two or more persons who are yet to come into legal existence, for a private ruling on how a taxation law applies, or would apply, to each person and to an arrangement (whether a single or a recurring arrangement). An application for a private ruling must be made on form IR713 and must:

(a) Identify the applicant;
(b) Disclose all relevant facts and documents relating to the arrangement;
(c) State the taxation laws in respect of which the ruling is sought;
(d) State the propositions of law (if any) which are relevant to the issues raised in the application; and
(e) Provide a draft ruling.

The CIR can waive the last three requirements if it would be unreasonable to require the applicant to comply with them. The CIR can also request further relevant information from the applicant.

The CIR can decline to make a private ruling if:

(a) The CIR considers that the correctness of the ruling would depend on assumptions about future events or other matters;
(b) The arrangement on which the ruling is sought, or separately identifiable part of that arrangement, is substantially the same as an arrangement which is subject to objection, challenge, or appeal in relation to the applicant or any other person; or
(c) The applicant has outstanding debts relating to earlier binding ruling applications.

The CIR is not able to make a private ruling if:

(a) The CIR is required to determine a “proscribed question” (unless the application relates to how ss GC 6 to GC 14 or YD 5 applies, or would apply, to the applicant and the arrangement (whether a single or recurring arrangement), for which the ruling is sought). A proscribed question means whether a fact is correct or exists; what a person’s purpose or intention is; what the value of something is; or what commercially acceptable practice is (for the purposes of any provision of the ITA 2007 which refers to the latter concept);
(b) In the CIR’s opinion the arrangement is not seriously contemplated by the applicant; or
(c) The application is frivolous or vexatious; or
(d) The matter on which the ruling is sought:
   (i) Concerns a tax (excluding provisional tax), duty, or levy that is already due and payable, unless the application was received by the CIR before the tax (excluding provisional tax), duty, or levy became due and payable; or
   (ii) Is being dealt with or, in the CIR’s opinion, should be dealt with under a double taxation agreement procedure; or
(e) A private ruling already exists dealing with the same taxation law, person, and arrangement, and the proposed ruling would apply (wholly or partly) to the same period or tax year; or
(f) An assessment relating to the person, the arrangement, and a period or tax year to which the proposed ruling would apply has been made, unless the application is received by the CIR before the date an assessment is made [see TIB vol 20:5 (June 2008) at 13-15]; or

(g) The CIR is auditing or investigating how the taxation law applies to the person and the arrangement for any period or tax year to which the proposed ruling would apply; or

(h) The application is for a ruling in relation to a tax type or a separately identifiable issue, for an arrangement, that is the subject of a NOPA for the arrangement; or

(i) The applicant has not provided sufficient information in relation to the application after the CIR has requested further information; or

(j) The CIR believes it would be unreasonable to make a ruling in view of the resources available to the CIR; or

(k) The application for the ruling requires the CIR to form an opinion as to a generally accepted accounting practice.

If the CIR considers that the correctness of a private ruling would depend on assumptions regarding future events or other matters, the CIR can either make appropriate assumptions when making the ruling or decline to make the ruling. The CIR cannot make assumptions about information which the applicant is able to provide.

The CIR may make assumptions about the answer to a proscribed question, and in doing so, the CIR will not infringe the rule which prevents the CIR from ruling where the CIR has to determine a proscribed question. That is, making assumptions about the answer to a proscribed question does not prevent the CIR from also making the private ruling itself.

If the proposed ruling differs from that requested by the applicant, the CIR must consult with the applicant before making the ruling.

A private ruling must state:

(a) That it is a private ruling made under s 91E of the TAA;

(b) The identity of the person, the taxation law, and the arrangement to which the ruling applies;

(c) How the taxation law applies to the arrangement and to the person;

(d) The period or tax year for which the ruling applies;

(e) Material assumptions about future events or other matters made by the CIR; and

(f) Conditions stipulated by the CIR.

The CIR may stipulate conditions about the answer to a proscribed question, and in so doing the CIR will not infringe the rule which prevents the CIR from ruling where the CIR has to determine a proscribed question. That is, stipulating conditions about the answer to a proscribed question does not prevent the CIR from also making the private ruling itself.

The CIR notifies the making of a private ruling by sending a copy of the ruling to the applicant.

If a private ruling applies to a person in relation to an arrangement and a tax type for an arrangement, and the person applies the taxation law for the tax type in the way stated in the ruling, the CIR must apply the taxation law in accordance with the ruling unless the taxpayer has issued the CIR with a NOPA to change the effect of the ruling previously applied by the taxpayer.

A private ruling applies to a person and an arrangement only if the taxation law for a tax type is expressly referred to in the ruling. A private ruling binds the CIR only for the period or tax year for which the ruling applies. A person cannot apply a private ruling to a tax type for an arrangement to the extent to which, in relation to the tax type:

(a) The arrangement is materially different from that identified in the ruling;

(b) There was a material omission from, or misrepresentation in, the application for the ruling;
115.50(1) Binding Rulings

(c) The CIR makes an assumption about a future event or another matter material to the application of the ruling, and that assumption subsequently proves to be incorrect; or

(d) The CIR stipulates a condition that is not satisfied.

(1) Withdrawal of private ruling

The CIR can withdraw a private ruling at any time by notifying in writing the person to whom the ruling applies. The ruling is withdrawn from the date specified in the notice of withdrawal. This date cannot be earlier than the date on which the person could reasonably be expected to receive the notice.

A status ruling on a withdrawn private ruling ceases to apply from the date specified in the notice of withdrawal.

Once a private ruling is withdrawn, it does not apply to any arrangement entered into after the date of withdrawal, but it continues to apply to any arrangement entered into before the date of withdrawal for the remainder of the period or tax year specified in the ruling.

A status ruling on a withdrawn private ruling continues to apply to any arrangement entered into before the date of withdrawal for the remainder of the period or tax year specified in the private ruling.

(2) Treatment of information

The information supplied by the applicant is the factual basis for the CIR’s ruling. Nevertheless, the CIR may as part of the process of making the private ruling, inquire into the correctness or existence of those facts. Further, the CIR is not prevented from later denying, outside of the ruling process, the correctness or existence of the facts contained in the information supplied by the applicant.

115.60 Product rulings [TAA, ss 91F, 91FA, 91FB, 91FC, 91FD, 91FE, 91FF, 91FG, 91FH, 91FJ, 91FK, 141EC]

Any person, either in their own right or on behalf of an entity yet to come into legal existence, may apply to the CIR for a product ruling on how a taxation law applies, or would apply, to an arrangement or to the consumer of the product and the arrangement. The person making the application (or the prospective person) must intend to be a party to the proposed arrangement or a promoter of the proposed arrangement.

A “promoter” means a person who is a party to, or is significantly involved in formulating, a plan or programme from which an arrangement is offered; or a person who is aware of material and relevant aspects of the arrangement and who sells, issues or promotes the selling or issuing of, the arrangement, whether or not they receive payment for doing so. A person who merely provides legal, accounting, clerical or secretarial services to the promoter is not themselves a promoter.

A “consumer” is a party to the arrangement who is not the applicant.

An application for a product ruling must be made on form IR714 and must:

(a) Identify the applicant;

(b) Disclose all relevant facts and documents relating to the arrangement for which the ruling is sought;

(c) If the applicant is a promoter of the arrangement, make a statutory declaration that all relevant facts and documents have been disclosed, and that all relevant facts are correct;

(d) Explain why it is not practicable to seek a private ruling and why the characteristics of the taxpayers who may enter into the arrangement are not relevant to the content of the ruling;

(e) State the taxation laws in respect of which the ruling is sought;

(f) State the propositions of law (if any) which are relevant to the issues raised in the application; and

(g) Provide a draft ruling.

The CIR can waive requirements (e) to (g) if the CIR considers it would be unreasonable to require the applicant to comply with them. The CIR can also request further relevant information from the applicant.

The applicant may withdraw a product ruling application at any time by notifying the CIR in writing.

The CIR can decline to make a product ruling if:
(a) The CIR considers that the correctness of the ruling would depend on assumptions about future events or other matters;
(b) The arrangement on which the ruling is sought, or a separately identifiable part of that arrangement, is substantially the same as an arrangement which is subject to objection, challenge, or appeal in relation to the applicant or any other person; or
(c) The applicant is a promoter who in the CIR’s opinion, did not comply with the relevant disclosure requirements (see above) in relation to an earlier binding ruling application; or
(d) The applicant has outstanding debts relating to earlier binding ruling applications.

The CIR is not able to make a product ruling if:

(a) The CIR would be required to determine a proscribed question. A proscribed question means whether a fact is correct or exists; what a person’s purpose or intention is; what the value of something is; or what is commercially acceptable practice (for the purposes of any provision of the ITA 2007 which refers to the latter concept);
(b) In the CIR’s opinion, the arrangement is not seriously contemplated by the applicant;
(c) The application is frivolous or vexatious;
(d) The matter on which the ruling is sought is being dealt with or, in the CIR’s opinion, should be dealt with under a double taxation agreement procedure;
(e) A product ruling already exists on how the relevant taxation law applies to the arrangement, and the proposed ruling would apply (wholly or partly) to the same period or tax year;
(f) The applicant has not provided sufficient information in relation to the application after the CIR has requested further information;
(g) The CIR believes it would be unreasonable to make a ruling in view of the resources available to the CIR; or
(h) The application for the ruling requires the CIR to form an opinion as to a generally accepted accounting practice.

If the CIR considers that the correctness of a product ruling would depend on assumptions regarding future events or other matters, the CIR can either make appropriate assumptions when making the ruling or decline to make the ruling. The CIR cannot make assumptions about information which the applicant is able to provide.

The CIR may make assumptions about the answer to a proscribed question, and in doing so the CIR will not infringe the rule which prevents the CIR from ruling where the CIR has to determine a proscribed question. That is, making assumptions about the answer to a proscribed question does not prevent the CIR from also making the product ruling itself.

If the proposed ruling differs from that requested by the applicant, the CIR must consult with the applicant before making the ruling.

A product ruling must state:

(a) That it is a product ruling under s 91F of the TAA;
(b) The name of the person who applied for the ruling;
(c) The taxation law and the arrangement to which the ruling applies;
(d) How the taxation law applies to the arrangement;
(e) The period or tax year for which the ruling applies;
(f) Material assumptions about future events or other matters made by the CIR; and
(g) Conditions stipulated by the CIR.

The CIR may stipulate conditions about the answer to a proscribed question, and in doing so the CIR will not infringe the rule which prevents the CIR from ruling where the CIR has to determine a proscribed question.
That is, stipulating conditions about the answer to a prescribed question does not prevent the CIR from also making the product ruling itself.

The CIR must send a copy of the ruling to the applicant as soon as practicable after the date the ruling is made.

The CIR cannot publish a product ruling until two months after the date the ruling is made unless earlier publication is requested in writing by the applicant. If the applicant requests earlier publication, the CIR must notify the making of the product ruling by notice in a publication chosen by the CIR and publish the product ruling, in full, in an Inland Revenue publication. Only the applicant can obtain a copy of the product ruling before it is published by the CIR.

A product ruling cannot be extended; a fresh application for a product ruling must be made.

If a product ruling applies to a person in relation to an arrangement and a tax type for an arrangement, and the person applies the taxation law for the tax type in the way stated in the ruling, the CIR must apply the taxation law in accordance with the ruling, unless the taxpayer has issued the CIR with a NOPA to change the effect of the ruling previously applied by the taxpayer.

A product ruling on a taxation law for a tax type applies to an arrangement only if the taxation law is expressly referred to in the ruling. A product ruling binds the CIR only for the period or tax year for which the ruling applies. A person cannot apply a product ruling to a tax type for an arrangement, to the extent to which, in relation to the tax type:

(a) The arrangement is materially different from that identified in the ruling;
(b) There was a material omission from or misrepresentation in the application for the ruling;
(c) The CIR makes an assumption about a future event or another matter material to the application of the ruling, and that assumption subsequently proves to be incorrect; or
(d) The CIR stipulates a condition that is not satisfied.

(1) **Withdrawal of product ruling**

The CIR can withdraw a product ruling at any time by publishing a notice of withdrawal in a publication chosen by the CIR. The notice of withdrawal must state:

(a) That it is a withdrawal of a public ruling under s 91FJ of the TAA;
(b) The ruling that is being withdrawn;
(c) The original period or tax year for which the ruling applied;
(d) Any status ruling that applied to the product ruling;
(e) That the status ruling is also being withdrawn; and
(f) The date of the withdrawal.

The effective date of the withdrawal is the date stated on the notice of withdrawal. It can be no earlier than the date the notice is published in the publication chosen by the CIR.

A status ruling on a withdrawn product ruling ceases to apply from the date specified in the notice of withdrawal.

Once a product ruling is withdrawn, it does not apply to any arrangement entered into after the date of withdrawal, but it continues to apply to any arrangement entered into before the date of withdrawal for the remainder of the period or tax year specified in the ruling.

A status ruling on a withdrawn product ruling continues to apply to any arrangement entered into before the date of withdrawal for the remainder of the period or tax year specified in the product ruling.

(2) **Treatment of information**

The information supplied by the applicant is the factual basis for the CIR’s ruling. Nevertheless, the CIR may as part of the process of making the product ruling, inquire into the existence or correctness of those
facts. Further, the CIR is not prevented from later denying, outside of the ruling process, the correctness or existence of the facts supplied by the applicant.

(3) **Product rulings issued**

Copies of product rulings issued to date are available from Inland Revenue. Most product rulings are published in TIBs. All product rulings can be found in Brokers Tax Service or downloaded from Inland Revenue’s website [see www.ird.govt.nz].

115.70 **Status rulings** [TAA, ss 91GA, 91GB, 91GC, 91GD, 91GE, 91GF, 91GG, 91GH, 91GI]

If a taxation law that is stated as applying in a private or product ruling is amended or repealed, the person who applied for the ruling may apply to the CIR for a ruling on whether the law change has affected the way the law applies in the ruling. This type of ruling is called a “status ruling”.

The CIR must make a status ruling on whether the change in a taxation law, that is stated as applying in a private or a product ruling, has changed the way that the law applies in the ruling.

The CIR may make a status ruling on whether the change in a taxation law has changed the way that the law applies in a private or a product ruling, whether or not the application referred to that taxation law.

The CIR may not make a status ruling if:

(a) The application is frivolous or vexatious;
(b) The CIR considers that the correctness of the private or product ruling would depend on which assumptions were made about a future event or other matter; or
(c) The CIR considers that it would be unreasonable to make a ruling in view of the resources available to the CIR.

An application for a status ruling must be made on form IR712 and must:

(a) Identify the applicant;
(b) Identify the private or product ruling on which the status ruling is sought;
(c) State the taxation laws that are stated as applying in the private or product ruling that have been amended or repealed;
(d) State any propositions of law that are relevant to the issues raised in the application; and
(e) Provide a draft ruling.

If the CIR considers that it would be unreasonable to require the applicant to comply with either of the requirements in (d) or (e), the CIR may waive those requirements.

The CIR may at any time request further relevant information from an applicant for a status ruling.

Before the CIR makes a status ruling, the CIR must give the applicant a reasonable opportunity to be consulted if the content of the proposed ruling differs from that requested by the applicant.

A status ruling must identify the private or product ruling to which it applies and state:

(a) That it is a status ruling made under s 91GA of the TAA; and
(b) Whether the amendment or repeal of a taxation law has changed the way that the law applies in the ruling.

The CIR must send a copy of a status ruling to the applicant as soon as practicable after the date on which the ruling is made.

In the case of a status ruling on a product ruling, the CIR must also:

(a) Notify the making of a status ruling by notice in the *Gazette*; and
(b) Publish the status ruling in an Inland Revenue publication.
The CIR must notify the making of and publish a status ruling as soon as possible after the two-month period specified in s 91FH(3) of the TAA has passed, unless the applicant has requested earlier publication of their product ruling.

If a person applies a taxation law in accordance with a status ruling, the CIR must also apply the taxation law in accordance with the status ruling.

The CIR does not have to withdraw and reissue a new ruling to correct a typographical or a minor error if the correction does not change the meaning of the ruling. A ruling that is not withdrawn and reissued remains valid.

115.80 General provisions [TAA, ss 91G, 91H]

A binding ruling ceases to apply from the date a taxation law is repealed or amended, to the extent that the repeal or amendment changes the way the taxation law applies in the ruling [TAA, s 91G].

The fact that an application for a private or product ruling has been made does not release the applicant from the obligation to provide a return, make a tax payment, or do any other act, and does not affect the CIR’s power to make or amend any assessment [TAA, s 91H].

115.90 Fees for private and product rulings [TAA, s 91I]

Regulations prescribing or providing for the fixing of fees payable in respect of applications for private, product, and status rulings are made by Order in Council by the Governor-General. These regulations may specify the persons by whom fees are payable, prescribe specific fees for specific work or services, prescribe a scale of fees or a rate based on the time involved in carrying out the work or services, and allow the CIR to waive, in whole or in part, any fees that are payable [TAA, s 91I].

The Tax Administration (Binding Rulings) Regulations 1999 provide for the payment of fees for status, private, and product rulings as follows:

(a) An application fee of $310 to accompany the application. This fee covers the first two hours of work in processing the application.

(b) A further fee of $155 per hour (or part hour), for any hours in excess of the first two, spent by the CIR in processing the application, including any time spent in consultation with the applicant. This additional hourly fee is not payable for time spent by the CIR in considering:
   (i) The apportionment of income or expenditure under s YD 5 [see 1000.105]; or
   (ii) The determination of an arm’s length amount of consideration under ss GC 6 to GC 14 [see 1000.140].

(c) The reimbursement of any fees paid by the CIR for external advice sought, or of any costs and reasonable disbursements incurred by the CIR in relation to the ruling.

(d) If an application for a ruling is withdrawn, the applicant is liable to pay all fees incurred before the CIR received the notice of withdrawal.

(e) The CIR must make every reasonable effort to minimise the fees an applicant is liable to pay for a ruling.

(f) The CIR is required to provide the applicant with an estimate of any fees that are payable in excess of the application fee. If the CIR considers an estimate provided to an applicant is incorrect, the CIR must as soon as practicable revise the estimate and notify the applicant.

(g) The CIR may waive all or part of a fee payable under these regulations if the CIR considers it is fair and reasonable in the circumstances to do so, having regard to the nature of the issue that is the subject of the application, the level of skill and experience required in the consideration of the application, and any other relevant factors. This applies to applications for binding rulings received by the CIR on or after 7 September 2010.

(h) All fees are inclusive of GST. However, for a supply that is zero-rated, the fee prescribed by the regulations is reduced by an amount equal to the tax fraction of the fee under the GSTA. The tax
fraction is calculated in accordance with the formula in s 2(1) of the GSTA. This rule applies to applications for binding rulings received by the CIR on or after 7 September 2010.

The regulations also provide that if the CIR considers that it takes longer than four weeks to issue the ruling, the CIR must provide the applicant with an estimate of the likely date for the issue of the ruling. If the CIR considers that such an estimate given to an applicant is incorrect, the CIR must as soon as practicable revise the estimate and notify the applicant.

115.100 Non-binding statements

The CIR may issue three types of non-binding statements as well as binding public rulings. The following is the explanation of the three types of statements provided in TIB vol 8:2 (August 1996) at 1.

(1) Interpretation statements

These statements set out the CIR’s view of the law in cases where a binding public ruling cannot be issued or is inappropriate. For example, the CIR issued an interpretation statement as a result of the Court of Appeal decision in Newman v Commissioner of Inland Revenue (1995) 17 NZTC 12,097 (CA). Situations when a particular type of arrangement cannot be conveniently identified may also give rise to an interpretation statement.

(2) Interpretation guidelines

These statements discuss the CIR’s approach to the interpretation of a general area of law. A statement on the CIR’s approach to sham transactions or the interpretation of the general anti-avoidance provision in the ITA would be an example of the type of statement that might be issued as an interpretation guideline.

(3) Standard practice statements

These statements describe how the CIR will, in practice, exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts. An example of a statement on a practical issue is the CIR’s statement on the rates that will be accepted as “reimbursement” for the use of a motor vehicle.

115.110 Impact of company amalgamations on binding rulings [s FO 4]

There is no provision in the TAA or the ITA which specifically addresses the issue of whether an amalgamated company is entitled to rely, after amalgamation, on a binding ruling issued to one of the companies prior to amalgamation. However, s FO 4 provides, among other things, that when an amalgamating company ceases to exist on amalgamation, the amalgamated company is entitled to the rights, powers and privileges of the amalgamating company under the Inland Revenue Acts for the tax year corresponding to the income year of amalgamation and all earlier tax years.

An Inland Revenue interpretation statement considers that an amalgamated company is entitled to rely on private, product, or status rulings that an amalgamated company was previously entitled to rely on. However, the ability to rely on a pre-amalgamation ruling is subject to the amalgamated company continuing to fulfil any conditions and assumptions specified in the ruling, and the arrangement not being materially different to the arrangement ruled upon. This applies to a ruling that could be relied upon by either an amalgamating company (which ceases to exist after amalgamation) or an amalgamated company. Inland Revenue considers that the right to rely on a pre-amalgamation ruling also arises by virtue of the principle of “continuance” set out in s 225(d) of the Companies Act 1993 [see TIB vol 17:6 (August 2005) at 12-19].
Chapter 120
Building Societies

120.10 Taxation and deductions [s DV 10]
Income tax is imposed on the taxable income of a building society at the company rate. A building society is allowed a deduction for the following expenditures:

(a) Any expenditure incurred for money borrowed in the form of withdrawable shares (e.g., dividends on fixed deposit accounts, savings accounts, and bonus balloting shares). The timing of this allowable deduction is determined under the financial arrangements rules [see 470 FINANCIAL ARRANGEMENTS].

(b) Any interest and other financial charges incurred in providing money used in the income year to make an interest-free loan to any holder of a terminating share.

(c) Any payment made in purchasing any balloted loan right from a holder of any terminating share. A “balloted loan right” means a right arising from a ballot of terminating shares, where the ballot was held to ascertain which of the holders of the shares are entitled to receive an interest-free loan for those shares.

120.20 Assessability of distributions
The following rules apply to distributions from a building society:

(a) Dividends derived by a New Zealand resident company from a building society registered under the Building Societies Act 1965 are taxable to the company;

(b) Dividends paid on withdrawable shares are interest for RWT purposes [see 1260.25].

(c) Any tangible or intangible benefit derived by a building society member or shareholder, on sale back to the building society, of shares in the society are defined as an investment society dividend and income. This need not be in money, nor convertible into money [s YA 1];

(d) A cash prize received under s 31A of the Building Societies Act 1965 is income derived on the day the bonus ballot giving the prize is held;

(e) A cash prize received under s 31A of the Building Societies Act or equivalent benefit is interest for income tax purposes [s CC 6]; and

(f) A cash prize which would otherwise have been received but which is taken in the form of an advance is income on the day the first payment of the advance is made.
Chapter 130

Business

130.10 Business definition is linked with a motive of profit [ss BC 4, CB 1, YA 1]
A “business” includes any profession, trade, or undertaking carried on for profit [s YA 1]. This definition of a business is not exhaustive. In ordinary circumstances no difficulty arises in determining when a business exists. The difficulties arise in cases of unusual transactions or transactions not in the ordinary course of trading. The question is one of law and is so wide that a discussion of it is outside the scope of this book. For tax purposes, an illegal activity may constitute a business.

This definition has been interpreted as meaning that the operations must be carried on to such an extent, or in such a manner that it could reasonably be expected that they would result in a profit. The fact that the operations in one year (particularly in the initial stages), may result in a loss, would not in itself exclude them from being a business undertaking if there remained the intention to derive income. Consistent losses may, however, point to an activity which could not be classed as a business.

Gross business receipts are included in assessable income [s CB 1] and where business losses occur in an income year, the excess allowable deductions are included in calculating the net loss for that income year [s BC 4]. In the entertainment tax regime “business” includes any recurrent income-earning activity.
See also the Inland Revenue Booklet Smart Business (IR320).

130.20 The consequences of being found not to be in business [s DA 1]
If a business is not being carried on, expenditure and losses associated with the operation are not allowed as a deduction unless they are incurred in deriving assessable or excluded income for any income year. Where expenditure is incurred in carrying on a business, it is deductible even where no income is derived by the business in that year [s DA 1]. The business test is based on the circumstances that existed at the time. There is also the question of whether a person is an employee or an independent contractor to consider [see 335 EMPLOYMENT RELATIONSHIP].

130.30 Costs incurred on cessation of business
Expenses and losses incurred after a business ceases are unlikely to meet the business nexus test for deductibility. However, in some situations a deduction may still be allowed if the expenditure or loss was incurred in deriving assessable or excluded income prior to cessation.

In TRA Case N7 (1991) 13 NZTC 3,048, (1990) 15 TRNZ 519, the liability for a debt incurred prior to the termination of a partnership plus accrued interest was held not deductible following the termination of the partnership.
In *IT Case No 490* (1942) 12 SATC 72, maintenance expenses on property, e.g., rent, rates, repairs, incurred during the income year after the closing down of a business were not allowable as a deduction from income derived prior to the date of cessation.

In *TRA Case F73* (1983) 6 NZTC 59,931, the taxpayer owned a fishing boat which was removed from water to await sale. Expenses relating to the vessel of insurance, interest, and depreciation were deducted from the taxpayer’s income. The TRA held that the taxpayer did not discharge the onus of proof to show that the expenditure was made otherwise than to preserve the vessel for sale as a going concern.

### 130.40 Expenditure incurred before start of business

Expenditure preparatory to the commencement of a business is of a capital nature and non-deductible: *TRA Case L73* (1989) 11 NZTC 1,426, applying the principles of *Calkin v Commissioner of Inland Revenue* (1984) 6 NZTC 61,781 (CA). Preliminary expenses are neither incurred in carrying on a business nor incurred in deriving assessable or excluded income. Therefore they do not satisfy the nexus tests for deductibility in s DA 1 and cannot be allowable deductions. Examples of preliminary expenses include legal costs of preparing a company’s constitution and issuing share capital.

### 130.50 Business case law

*Grieve v Commissioner of Inland Revenue* [1984] 1 NZLR 101, (1984) 6 NZTC 61,682, (1983) 6 TRNZ 461 (CA) is the most compelling authority on the business test. The case concerned a husband and wife partnership that was developing a 216-acre beef unit. The farm had traded at a loss for the previous six years with accumulated losses of about $19,000 and the CIR sought to disallow the losses on the basis that there was no reasonable prospect of the farm producing a profit. However, the Court of Appeal held that a taxpayer is in business merely if there is an intention to make a profit, and the Grieves having that intention were held to be in business despite the accumulated losses. Richardson J cited the following factors as relevant to ascertain whether the taxpayer could have held an intention to make a profit:

(a) The nature of the activity;
(b) The period over which it was engaged;
(c) The scale of operations and the volume of transactions;
(d) The commitment of time, money, and effort;
(e) The pattern of activity and financial results; and
(f) Whether the activity is of the same kind and carried on in the same manner as would be expected from a “profitable” farm, in the sense that the usual operations are characteristic of a type of “profitable” farming.

Prior to this decision the Courts had held that a business for tax purposes existed when a taxpayer had both the intention of making a profit and a reasonable prospect of making a profit in the future. The Court also discussed what constituted a “pecuniary profit” under the definition of business. It held that pecuniary profits were to be ascertained on ordinary commercial principles, and were not to be equated with profits for tax purposes. Therefore, capital expenditure and other incentive deductions should be disregarded in determining whether a business is carried on for pecuniary profit.

Following this decision Inland Revenue released a technical circular outlining its policy for determining whether a taxpayer is carrying on a business. The circular stated:

“In *Intention* is not to be judged purely subjectively, but is to be determined by taking into account not only the words of the taxpayer but also actions. A totally unrealistic venture could be excluded on this test on the basis that no reasonable person could realistically have expected (and thereby by implication intended) to make a pecuniary profit having regard to the manner in which the activity was conducted. As a practical measure in evaluating the taxpayer’s actions, the IRD will consider the various matters of inquiry as suggested by the Court.

“In order to gauge the extent of a taxpayer’s operations the IRD will continue to request details of development plans and budgets of income and expenditure where necessary. These will give
an indication of the manner in which the activity is to be carried on and whether the necessary intention to make a profit exists. However, the taxpayer must be able to show that the plans have been carried into practical effect if credence is to be given to the taxpayer’s stated intention. There may be deviations from the stated plan or budget for very good commercial reasons or because of factors outside the taxpayer’s control which were not anticipated at the time and where these exist, they would not necessarily affect the acceptance of the venture as a business. As indicated by the Court in the final analysis it is the character and circumstances of the particular venture which are crucial and each case must be considered according to its own facts.

(1) Profit prospects

*TRA Case C3* (1977) 2 TRNZ 175 concerned a taxpayer who, in 1964, while still serving as an officer in the Royal New Zealand Navy, bought a 50-acre farm property which was swampy and in poor condition and was situated some 140 miles from his home in Auckland. Improvements were made up to 1968 but no claim was made for expenditure incurred. In 1968 the taxpayer began to run sheep on the property, carrying an average of 27 sheep a year in the years 1969 to 1974. He estimated he spent 90 per cent of his weekends and his periods of leave working on the farm. During week days, a neighbour looked after the sheep, moved them when necessary and arranged for shearing at appropriate times. The taxpayer claimed for farm losses for the years 1969 to 1974 inclusive and again in 1975. Losses for the earlier years were allowed by Inland Revenue but that sustained in 1975 was disallowed as it was considered the taxpayer was not in business. That view was supported by a report from a farm advisory officer who stated the property was unlikely to be an economic unit under conventional livestock farming. The taxpayer failed to demonstrate before the TRA that he was carrying on a business within the meaning of the legislation with a view to making a profit and that he had a reasonable expectation of so doing. The TRA held that as far as the 1975 year was concerned the objection to disallow the loss must fail.

In *TRA Case H63* (1986) 8 NZTC 460, in 1981 a naval officer purchased a 74-acre property for his retirement in eight years’ time and leased 62 acres to a neighbour. He worked on the farm in his holidays for about two months a year, his father managing the property in his absence. In the 1983 income year 10 stock were run and a loss of $2,061 was incurred. The taxpayer’s plans showed profitability should be achieved within five years. The TRA held there was an inadequate level of activity to support the business concept having regard to the taxpayer’s personal farming activity and to his letting and other activities with regard to the 74 acres, most of which activities could only be related to the holding, preserving, and improving of the 74-acre capital asset. During the 1983 income year the taxpayer did not have a genuine intention to achieve a profit.

In *TRA Case 4* (1981) 5 TRNZ 44, the taxpayers’ plans for an amusement park project were delayed. In the meantime the taxpayers grazed sheep on the land. It was held that the intention to make a profit out of the grazing activities had not been established and the disallowance of the loss relating to those activities was therefore upheld.

In *TRA Case F3* (1983) 6 NZTC 59,575, the taxpayer was a medical specialist who, in 1974 and 1976, purchased a five-acre and a 27-acre block of rural land respectively. After unsuccessfully breeding cattle, he sold them and purchased black sheep which he also sold following a fall in black wool prices. In 1979 he began to grow a licorice crop which was destroyed by an accidental spraying of poison. It was held the activities constituted a business because the taxpayer throughout showed an intention of making a profit and there was a reasonable prospect of doing so.

In *TRA Case J2* (1987) 9 NZTC 1,004, it was held that once a taxpayer reached a conclusion that he could never farm his property at a profit, a business could not exist.

In *TRA Case J78* (1987) 9 NZTC 1,459, the taxpayers farming on a reduced scale with knowledge that a profit would not be made were held not to be in business.

In *TRA Case K36* (1988) 10 NZTC 308, husband and wife farmers progressively subdivided a farm, continuing to farm the reduced area and for four income years the operations made losses, followed by a small profit. The CIR disallowed the loss deductions on the ground the venture was not a “business”. On the facts it was held to be a business, as the parties were intent on operating the business and carrying on farming for a pecuniary profit.
In Mainzeal Holdings Ltd v Commissioner of Inland Revenue (2000) 19 NZTC 15,914 (HC), Mainzeal Holdings (MH) was a privately owned property development company with interests in both New Zealand and Australia. Mainzeal Australia (MA) was a subsidiary of MH carrying on business as a property developer in Australia. MA purchased sites in Queensland for commercial development. One of the sites was developed but difficulties were encountered in obtaining tenants, due to a market downturn. Development of a second site did not proceed. MA informed MH that it required financial assistance. A formal deed was entered into whereby MA would pay all expenses in respect of its business operations, MA would collect all rents from its business operations, MH would pay a fee to MA in partial reimbursement for its continuation in business, and the net profit from the eventual sale of the sites would be apportioned between MH and MA. The CIR disallowed the deduction claimed by MH for the fees paid to MA. The grounds for disallowance were that the amounts paid were not fees but, rather, injections of capital. In the High Court, Nicholson J considered that the true nature of the payments was that of an investment of capital. MH appealed the decision to the Court of Appeal where Blanchard J, citing the decision in Grieve (above), found that there was no prospect of profit for the joint venture and that MH had not established that it genuinely had a profit-making intention or purpose when the venture was entered into. Therefore, the expenditures were not deductible: Mainzeal Holdings Ltd v Commissioner of Inland Revenue (2001) 20 NZTC 17,409 (CA).

(2) Constitutions

The business of a company is generally defined by its constitution. Transactions which would not ordinarily constitute the carrying on of a business in a general sense may, in specific circumstances, amount to the carrying on of a business. When an association or a company is formed for a purpose, that purpose is its business. A single transaction effected by a company within the ambit of its purposes may constitute the carry-on of its business: Commissioner of Taxes v Miramar Land Co Ltd (1906) 26 NZLR 723 (CA).

In a Malaysian case American Leaf Blending Co v Director-General of Inland Revenue [1978] 3 All ER 1185 (PC), it was decided by the Privy Council that the company, in letting its premises (which it was authorised to do by its memorandum), was carrying on a “business”, thus enabling it to deduct from the rents earlier business losses. The Board pointed out that the memorandum, while not conclusive in law, is very persuasive and in fact raises a presumption that any activity covered by it is a business.

The question was not so much whether the company had power to buy land and to sell it again but whether, in fact, its business as carried on comprised dealings in such property: James Shand & Co Ltd v Commissioner of Taxes [1928] GLR 411. Further, the profits of a business are not taxable unless two parties can be distinguished: the person who makes the profit, and the person from whom the profit is made. Where these two parties are identical, no taxable profit can be derived from their mutual transactions. Thus, in the case of certain clubs and similar institutions, where the transactions were confined to the members, the so-called profits have been held to be mere overcharges and not assessable profits.

(3) Extent of activities

A business must be habitually or systematically exercised; it is not constituted by isolated transactions: Erichsen v Last (1881) 1 TC 351. However, “habitually” does not imply frequency. There is no difference between making one contract to govern all the transactions of a year and dealing with each transaction separately: De Beers Consolidated Mines Ltd v Howe (Surveyor of Taxes) [1906] AC 455, (1906) 5 TC 198 (HL). A business may be habitually or systematically carried on, although a very few transactions, or only one, may be effected, as, for example, only one contract in the course of it: Californian Copper Syndicate v Harris (1904) 5 TC 159 IH (2 Div).

In Stevens v Commissioner of Inland Revenue (1989) 11 NZTC 6,001 (HC), a business was held not to have commenced where orders had been obtained but were not fulfilled because of difficulties in obtaining a manufactured article. The decision of MNR v MP Drilling Ltd 76 DTC 6,028 was approved to the effect that a business had commenced, notwithstanding ultimate abandonment, where associations had proceeded with suppliers and potential foreign customers, culminating in expressions of intent. The permanent structure, the market and the products all existed and the taxpayer’s efforts were directed to bringing them together with a resultant profit.
Whether a business exists is determined by the intention of the taxpayer (as compared to the motive) as evidenced by the taxpayer’s conduct: *G v Commissioner of Inland Revenue* [1961] NZLR 994 (SC). In that case, an evangelist supported by unsolicited voluntary donations was held to have the intention of making a profit because he knew gifts would be made to him which would be used by him for his support and maintenance. He was in business.

In *TRA Case H19* (1986) 8 NZTC 206, it was held that a venture which had not gone beyond a preliminary or preparatory stage had not blossomed into a business despite several months work and subsequent abandonment when the Customs Department lost a vital product. The view that all that is necessary for a valid business is to create a customer was rejected. A retired couple with $30,000 lent on mortgage with loans continually renewed or readvanced over a 13-year period were held to be carrying on a business: *TRA Case H27* (1986) 8 NZTC 264.

In *TRA Case K37* (1988) 10 NZTC 314, a butcher was held to have carried on a gambling business. His gambling was large scale, time-consuming, well organised, serious, and planned. It involved an accounting operation and took up a significant part of his daily living. His continued repeated and regular large scale betting set it apart from that of more casual, less organised punters.

In *TRA Case J84* (1987) 9 NZTC 1,486, a five-year substantial commitment of time and effort, which could only be equated with the seeking of profit, was held on the facts to be sufficient to justify an allegation that a horticultural business existed.

In a stock agent/auctioneer’s practise of buying up cattle and sheep left over after auction and selling them later at a profit was held over time to constitute a business: *TRA Case K80* (1988) 10 NZTC 639.

In *TRA Case L19* (1989) 11 NZTC 1,125, a farming activity which had incurred losses for 10 income years prior to making a modest profit was held to be “business”: *TRA Case L12* (1989) 11 NZTC 1,090.

In *TRA Case Q17* (1993) 15 NZTC 5,092, a polytechnic lecturer reduced his teaching duties from full time to part time so that he could spend more time developing his farming and rental properties. His primary income over the relevant period was derived from lecturing. There was no farming income other than a small amount from grazing and from the rental of a beach house. The CIR only allowed deductions to the extent of that income. Although the taxpayer spent considerable time and money in developing the two farm properties (1.05 and 28.8 hectares respectively), they were never viable economic units. He later sold one of them at a small profit. The other was on the market at the date of the hearing. The taxpayer maintained that he undertook all his activities on the properties for business purposes, with the intention of making a profit. Since the relevant period, he had moved to another area, bought and sold 20 hectares as a potential lifestyle block, and then purchased another 68 hectare block. Throughout the relevant period he had appraised other properties for purchase and development but had been unable to obtain finance to purchase them. The TRA held that the taxpayer was not in business and that expenditure incurred in developing the farming and rental properties was only preparatory to an income earning process. However, since one of the taxpayer’s purposes in acquiring the properties was the purpose of resale, the TRA applied the *Inglis and Stockwell* decisions and held that the taxpayer’s expenditure on the farm properties must be regarded as being in respect of circulating capital held on the revenue account. Accordingly, the expenditure was deductible.

In *TRA Case H89* (1986) 8 NZTC 615, a serviceman posted overseas rented his property and in the year in question did not intend to reoccupy. A contention of dual purpose failed, the serviceman being held to be in the business of renting for a profit.

In *Land Projects Ltd v Commissioner of Inland Revenue* [1964] NZLR 723 (SC), a business was held to have existed during the nine-day period during which a farm (purchased as a going concern) was owned.

In *Commissioner of Inland Revenue v Watson* (1993) 15 NZTC 10,010 (HC), consultancy activities conducted by the taxpayer on a part-time basis amounted to a business carried on for pecuniary profit.

In *TRA Case R10* (1994) 16 NZTC 6,059, a business was not being carried on by taxpayers who abandoned their intention to build and operate boarding kennels on a rural property when it was realised that the zoning conditions attached made it impossible to establish the kennels on the property without further planning.
consent. When a second property was acquired to establish the boarding kennels, the deductions claimed for losses incurred for the first property were disallowed.

In *Pukepine Sawmills Ltd v Commissioner of Inland Revenue* (1985) 7 NZTC 5,114 (CA), the taxpayer acquired an interest in a forestry business and entered into an agency agreement whereby the agent was required to plant, maintain, and dispose of timber. The Court of Appeal held that the taxpayer was not engaged in a forestry business. The agency deed did not contain any provisions for the direction, control, or supervision by the taxpayer or any provisions for the taxpayer’s rights to information.

However, in another case the High Court held that the taxpayer was carrying on a forestry business: *AM Bisley & Co Ltd v Commissioner of Inland Revenue* (1985) 7 NZTC 5,082 (HC). The case was distinguished from *Pukepine* as the management agreement gave Bisley the right to direct employment of a forester or consultant and the right to receipt of management reports. Thus, the extent of delegation in the management agreement was not so complete as to detract from the fact that Bisley carried on the business.

In *TRA Case H106* (1986) 8 NZTC 707, an evangelist was held not to be in business for tax purposes as he had no intention of making a profit and no organisation or arrangement existed for that purpose.

To prove change of purpose of use of an asset there must be positive proof of change and not merely proof of knowledge of unprofitability which has given rise to the making of short term arrangements: *New Zealand Co-operative Dairy Co Ltd v Commissioner of Inland Revenue (No 2)* (1989) 11 NZTC 6,066 (HC).

In *Commissioner of Inland Revenue v Port Chalmers Waterfront Workers Union* (1996) 17 NZTC 12,523 (CA), payments received and invested by a union over a number of years were exempt from income tax because they were not derived from “business carried on”.

In *TRA Case S53* (1996) 17 NZTC 7,347, it was held that it is not unlawful for a taxpayer to offer services to a company in return for a salary and then offer professional services to the public without reference to the company.

In *Slater v Commissioner of Inland Revenue* (1996) 17 NZTC 12,453 (HC), a die-owning partnership was entitled to deduct general expenditure and depreciation for one income year despite producing no income.

### 130.60 Deciding whether an operation is a business or hobby

The following are examples of the kind of small venture which may be either the carrying on of a business or the indulging of a hobby:

(a) Farmlets of a few acres bordering taxpayers’ private residences;

(b) Boat owners receiving small amounts from fish sales but incurring outgoings on their boats each year considerably in excess of the receipts; and

(c) Owners using assets such as boats largely for private purposes but also claiming they are available for hire, the hire charges usually being considerably less than the outgoings and depreciation [see PIB 105 (June 1980) and PIB 118 (November 1982)].

The fundamental matters to consider are:

(a) Whether the operations are such that they can be said to be a business undertaking, ie carried on with the intention of making a profit; or

(b) Whether the operations should be disregarded for tax purposes as being the indulgence of a hobby or being carried on in such a small way that the receipts merely defray expenses incurred in holding the asset for purposes other than business operations.

### 130.70 Cases on whether an operation is a business or hobby

In *TRA Case F15* (1983) 6 NZTC 59,627, an employee of a local body acquired a fishing boat for hobby purposes. Encouraged by her catches, she further equipped the vessel and extended her activities into a commercial operation. In the next year poor catches were common and a loss resulted. The CIR disallowed the loss claiming it resulted from a hobby but it was held to be a part-time business and the loss allowed
In TRA Case H86 (1986) 8 NZTC 597, the objectors were held to be either pursuing a hobby interest or were getting together a sufficient capital base of horses to begin a horse breeding business.

In TRA Case K40 (1988) 10 NZTC 343, the objectors were held to be in a stud breeding business.

In TRA Case K65 (1988) 10 NZTC 520, the taxpayer’s claimed “hobby” of raising and breeding of horses was, on the facts, held to be a “business”. The activities were coherently organised and conducted in a businesslike manner.

In TRA Case L24 (1989) 11 NZTC 1,154, a taxpayer’s activity of restoring and selling vintage cars and of selling parts thereof was a “hobby” and not a business:

In TRA Case L57 (1989) 11 NZTC 1,326, a farmer was held to be also engaged in the profession of an artist with an objective of pecuniary profit. Accordingly, his claim for deduction of overseas travel and accommodation costs succeeded.

In Lawrence v Commissioner of Inland Revenue (1994) 16 NZTC 11,263 (HC), a loss suffered by a dentist from operating a launch was held to be non-deductible. There had been no serious inquiry into the feasibility of a chartering business before the taxpayer purchased the launch, and no serious attempt to promote the charter venture. There had been only a small proportion of chartering compared with personal use during the income year in question, the launch was not readily available for chartering, and after that year the taxpayer retained the launch for personal use [see TIB vol 6:2 (August 1994) at 29].

130.80 Considerations when purchasing a business

When purchasing a business run by a company, one of the first considerations is whether to continue trading as a company. If so, the next consideration is whether to use the existing company to continue trading (ie the purchaser just acquires the shares in the existing company and the existing company continues trading). An appropriate valuation of the shares to be taken over must be agreed on, but in the meantime all administration and operational functions usually do not need changing immediately.

The alternative is for the purchaser to arrange for a new or completely different company to purchase the trading assets as a going concern from the vendor company. In these circumstances, the vendor company remains in existence after it has sold its assets, and may get into a non-functional state with its capital represented by undistributed assets and waiting to be wound up.

The next paragraphs mention some of the issues needed to be addressed in either set of circumstances.

130.85 Purchase of shares in a company which continues running a business

Income tax matters to consider follow:

(1) Taxation liability of company

A company is a separate legal entity from its shareholders and, irrespective of its shareholders, Inland Revenue will look to the company in satisfaction of all taxation liabilities. It is a relatively simple matter to determine current taxation liability at the date of purchase and make an adjustment in the purchase price. On the other hand, it is not so simple to determine the liability which would arise if Inland Revenue were to investigate the affairs of the company subsequent to the date of the purchase and impose additional liability on account of errors in previous returns.

These investigations invariably go back four years and in certain circumstances Inland Revenue has powers of reassessment as well as publicity of the tax defaulter’s name which could be serious for the taxpayer. Although it is usual for the vendor to undertake liability for tax on income derived prior to the date of sale, such an agreement is purely a personal arrangement between the vendor and purchaser and is in no way binding on Inland Revenue. Even though the vendor may agree to be responsible for any tax liability of the company prior to the date of sale, Inland Revenue will look to the company for satisfaction of the liability. The purchaser should proceed very cautiously when buying shares, in order to avoid or minimise the risk of buying a taxation liability. Other contingent liabilities might also not be apparent.
(2) **Losses carried forward**
Where a company has sustained tax losses, these may be carried forward to be offset against income of subsequent years but subject to relevant continuity of shareholdings being maintained. If sufficient shares are sold, the right to carry forward losses will be lost [see 940 LOSSES].

(3) **Debtors**
The basis of valuation of debtors is always important, whether the business is a company or a sole trader. Where shares in a limited liability company are sold, the continuing entity of the company is not disturbed and the problems do not arise with debtors, as they might otherwise arise when the business trading assets are sold. The company would simply carry on and collect its debts in the ordinary way, and if any proved bad and were written-off they would be deductible at that point [see 90 BAD DEBTS AND BAD DEBT RESERVES]. The purchaser will, of course, be concerned with the value of debts but only as part of the process of determining the quantum of purchase price. The purchaser should watch that there is no reserve for bad debts: a reserve is not allowable as a deduction for income tax purposes and in any case where a bad debt reserve exists there is a liability for tax on discovery by Inland Revenue. The only reserve permitted for debtors is a discount reserve for debtors as at balance date to whom discount at current commercial rates will be allowed on settlement.

(4) **Stock reserves**
The purchaser will be vitally concerned with the existence of a stock reserve, ie trading stock which has illegally not been disclosed for income tax purposes. There is a taxation liability on the amount of the undisclosed reserve and this affects the valuation of the business. Stock reserves may exist which have been disclosed to Inland Revenue for tax purposes, but which may not have been disclosed for financial reporting purposes. Inquiries should be made into the methods of stock valuation.

(5) **Revenue reserves**
If there are substantial revenue reserves, the inference is that the company has been ploughing back its profits in past years for the purpose of building up the business, and that the reserves are probably represented by fixed assets. If so, the company has already reached the stage where consideration should be given to capitalising accumulated profits, which is normally accomplished by making a bonus issue of shares. There are taxation implications arising [see 270 DIVIDENDS]. Furthermore, the consideration received by a vendor of shares wanting to avoid a potential taxable dividend where such reserves exist, may be treated by Inland Revenue as a dividend derived by the vendor of the shares [see 1340 SHARE SALES].

(6) **Imputation, withholding payment, and branch equivalent tax credits**
On a change of shareholding, the continuity of shareholding tests may not be met with the consequence that the credits will no longer be available. Advance planning prior to acquisition may be required [see 670 IMPUTATION].

(7) **Tax incentive deductions**
Where the company is receiving the benefit of concessions, these benefits remain with the company on a share transfer, whereas it would not necessarily follow that if the assets of a business were sold the purchaser of such assets would receive the same concession as that to which the company was entitled.

(8) **Asset values**
Market values of assets on a break-up basis may be substantially different from the value of the shares in a company.

130.90 **Purchase of business assets**
Income tax matters to consider follow.
(1) **Debtors**
Debtors represent an asset which may be sold like any other asset. To the purchaser the debtors taken over represent a capital asset and any subsequent loss on realisation is a capital loss, while any realisation in excess of the book value is a capital profit. It is necessary to value the debtors very carefully, as any writing off of book debts is not a permissible deduction, in these circumstances.

**TaxNote:** Most trade debtors will be excepted financial arrangements and not subject to the financial arrangements rules [see 470.25].

In *Wrightson Ltd v Commissioner of Inland Revenue* (1998) 18 NZTC 13,715 (HC), Wrightson NMA Ltd purchased farmers’ advance account debts from Dalgety Crown Ltd, at net realisable value less 10 per cent, as part of a merger agreement between the two companies. The High Court held that the subsequent profits or gains made by Wrightson NMA from the advance account debts were not gross income because the purchase of the debts was not part of any profit-making scheme. The purchase of the debts at a discount was to allow for the risk of default, not to create a margin for profit by the purchaser. The purpose of the taxpayer must be formed at the date the property is acquired.

(2) **Asset values**
Where a business is purchased as a going concern and no separate amount is allocated to the various assets comprising the business, the amount paid is required to be apportioned on the basis of relative market values. As a general rule, the agreement for sale and purchase specifies the separate amounts applicable to the various assets.

(3) **Goodwill**
There is a certain conflict of interests as between the purchaser and vendor as to the allocation of the purchase price between goodwill and other assets. Goodwill is normally neither assessable to the vendor nor deductible to the purchaser. The vendor would prefer to load the goodwill of the business at the expense of the stock and assets: the price received for stock represents income to the vendor and any amount received in excess of the book value of the plant, to the extent to which it does not exceed original cost, will be treated as depreciation recovered as income in the year of disposal. On the other hand, it is to the advantage of the purchaser to have a higher price allocated to stock and assets, as the cost of stock is allowable as a deduction in the first return of income and depreciation is allowable on the cost price of assets.

(4) **Goods and services tax**
The sale of a business as a going concern is zero-rated for GST [see 580 GOODS AND SERVICES TAX].

(5) **Granting of an annuity as part of the purchase consideration**
Where an annuity is granted as consideration or as part consideration on the purchase of a business, no deduction is allowable to the purchaser for annuity payments. Similarly, where property is purchased subject to the payment of an existing annuity, the annuity payments are not deductible by the purchaser [see 1120 PENSIONS AND ANNUITIES].

(6) **Sale of plant subsequent to purchase**
Where plant is sold within a short time subsequent to the date of purchase any loss on disposal is a capital loss. Inland Revenue takes the view that such a loss does not arise through use in the production of the purchaser’s income. This consideration would not apply where the shares in a limited liability company are purchased as the company would then be the taxpayer suffering the loss.

(7) **Repairs to newly-acquired assets**
If any of the assets purchased require repairs before being put into use, such repairs are a capital expense [see 1230 REPAIRS AND MAINTENANCE].
Chapter 150
Charities

150.05 General position
A range of tax incentives are available to charities and people who donate to them. These include:
(a) The non-business income of charities is exempt from income tax [see 150.10];
(b) The business income of charities used for charitable purposes within New Zealand is exempt from income tax [see 150.20];
(c) Cash donations by individuals to charities qualify for a tax credit equal to one-third of the amount of the donation [see 1395.75];
(d) Cash donations by companies to charities are deductible [see 300.20];
(e) Donations by Maori authorities to Maori associations and charities are deductible [see 950.50]; and
(f) Gifts to charities are exempt from gift duty (prior to 1 October 2011) [see 315.20].

The income of certain organisations which are not charitable, but provide some public benefit, is also exempt. These include:
(a) Friendly societies [see 225.50];
(b) Bodies promoting amateur games and sports [see 225.60];
(c) Bodies promoting scientific or industrial research [see 1240.30];
(d) Veterinary services bodies [see 370.15];
(e) Herd improvement bodies [see 370.15]; and
(f) Community trusts [see 370.15].

Non-profit organisations are allowed a deduction of up to $1,000 a year [see 225.60]. Further information on the tax incentives available to charities can be obtained from the Inland Revenue Booklet Charitable organisations (IR255).

150.10 Exempt non-business income [s CW 41]
All income derived by an organisation carried on for charitable purposes is exempt from income tax if, at the time the income is derived, the organisation is a tax charity. This applies to income derived by a trustee in trust for charitable purposes, and to income derived by societies and institutions established and maintained exclusively for charitable purposes and not carried on for the private pecuniary profit of any individual. The meaning of “charitable purpose” is explained in 150.40.

A “tax charity” means the trustee or trustees of a trust, society, or institution that is registered as a charitable entity under the Charities Act 2005 [see 150.50]. A tax charity also includes a non-resident organisation,
carrying out its charitable purposes outside New Zealand, which is approved as a tax charity by the CIR in circumstances where registration as a charitable entity under the Charities Act 2005 is unavailable.

The exemption does not apply to the business income of charitable trusts, societies or institutions. A separate exemption applies to the business income of charities [see 150.20]. The exemption also does not apply to income derived by council-controlled organisations, or by local authorities from council-controlled organisations, other than a council-controlled organisation operating a hospital as a charitable activity [see the definition of “council-controlled organisation” in s YA 1].

150.20 Exempt business income [s CW 42]

Income derived directly or indirectly from a business is exempt if the business is carried on by an organisation for charitable purposes in New Zealand and if, at the time the income is derived, the organisation is a tax charity. The term “tax charity” is explained in 150.10. The exemption applies to trusts established for charitable purposes, and to societies or institutions established and maintained exclusively for charitable purposes and not carried on for the private pecuniary profit of any individual. The exemption applies whether the business is carried on by, or for, or for the benefit of the charitable organisation. The meaning of “charitable purpose” is explained in 150.40.

A trustee is treated as carrying on a business if the trustee derives rents, fines, premiums or other revenues from an asset that was disposed of to the trust by a person having control over the business, as described in items (a) to (d) below, and either the person retains or reserves an interest in the asset or the asset will revert to the person.

The exemption does not apply if any person who has some control over the business is able to direct or divert an amount (which includes money or money’s worth) derived from the business to their own benefit or advantage. Any amount that is not exempt for this reason is trustee income. The exemption also does not apply to income derived by council-controlled organisations, or by local authorities from council-controlled organisations, other than a council-controlled organisation operating a hospital as a charitable activity.

If the charitable purposes of the organisation are not limited to New Zealand, income derived from the business in a tax year must be apportioned reasonably between charitable purposes in New Zealand and those outside New Zealand. Only the part of the income apportioned to New Zealand purposes is exempt.

(1) Control over business

A person is treated as having some control over the business of a charity, and as being able to direct or divert amounts from the business to their own benefit or advantage if in the tax year they are in any way, either directly or indirectly, able to determine or materially influence the determination of the nature or extent of a relevant benefit or advantage, or the circumstances in which a benefit or advantage is given or received, because they are:

(a) A settlor or trustee of the trust by which the business is carried on;
(b) A shareholder or director of the company by which the business is carried on;
(c) A settlor or trustee of a trust that is a shareholder of the company by which the business is carried on; or
(d) An associated person of any settlor, trustee, shareholder or director referred to in items (a) to (c).

A person is treated as a settlor of a trust, and as gaining a benefit or advantage in the carrying on of a business of the trust, if they have disposed of an asset to the trust that is used in carrying on the business, and they retain or reserve an interest in the asset or it will revert to them. Thus, income arising from any income-producing asset sold to the trust in these circumstances will not be exempt.

Persons (ie accountants or lawyers in public practice), who are in a position to determine or influence the nature or extent of benefits or advantages merely because they provide professional services to a business (including a trustee company, the Public Trust and the Maori Trustee) are not treated as having some control over the business for the purposes of the exemption.
The term “benefit or advantage” means something that may or may not be convertible into money, and includes income under one or more of the following provisions:

(a) Income under ordinary concepts [s CA 1(2)];
(b) Income from business or trade-like activities [ss CB 1 to CB 23];
(c) Property obtained by theft [s CB 32];
(d) Income from land [s CC 1];
(e) Income from financial arrangements [ss CC 3 to CC 8];
(f) Royalties [s CC 9];
(g) Dividends [s CD 1];
(h) Employment income [s CE 1];
(i) Attributed income from personal services [s CE 8];
(j) Benefits, pensions, compensation and government grants [s CF 1];
(k) Bad debt repayments [s CG 3];
(l) Attributed controlled foreign company income [s CQ 1]; and
(m) Foreign investment fund income [s CQ 4].

Specifically excluded from these items of income is interest earned on money lent if the interest paid does not exceed current commercial rates having regard to the nature and term of the loan.

150.30 Exempt charitable bequests [s CW 43]

Income derived by the executor or administrator of a deceased person’s estate is exempt income to the extent that:

(a) The income arises from or is attributable to assets of the estate that have been left to a trust established for charitable purposes, or to a society or institution established and maintained exclusively for charitable purposes and not carried on for the private pecuniary profit of any individual; and
(b) The income, if it had been derived by the charity, or by a business carried on by or for the charity, would be exempt under s CW 41 [see 150.10] or CW 42 [see 150.20].

In deciding whether the above requirements have been met, the following matters must be taken into account:

(a) The terms of the deceased person’s will, including the rights of annuitants, legatees, and other beneficiaries;
(b) The nature and extent of the debts and liabilities of, and other charges against, the estate and their likely effect on the income and assets available for distribution to the beneficiaries; and
(c) The shares and prospective shares of the beneficiaries in the income and assets of the estate.

The broad intent of s CW 43 is to exempt income accruing to an executor or administrator of a deceased’s estate to the extent to which the income can be said to arise from, or be attributed to, assets of the estate which have been bequeathed or devised to a charity. There can often be a considerable time-lag between the date of death and the distribution of an estate from which there has been a general or specific legacy to a charity. If the legacy could be handed over immediately the charity would be exempt from income tax on any income arising from the asset received. A delay in distribution would mean that income accruing after the date of death regardless of the ultimate destination of particular assets in the estate will be taxable. Section CW 43 thus enables income attributable to any assets that will ultimately pass to a charity to be exempt from income tax. It is recognised that administration of this provision may have problems and it is envisaged that there will be three main classes of cases arising.

Income derived by the deceased’s executor or administrator between the date of death and the end of the income year following the date of death will not be prevented from being exempt just because the charity is not registered as a charitable entity under the Charities Act 2005 [see 150.50]. The requirement in ss CW 41 and CW 42 that a charity must be registered in order for exemption to apply is
disregarded until the end of the income year following the income year in which death occurred. Any such income derived by the charity after this period will not be exempt, however, unless the charity has registered as a charitable entity.

Example:
Arthur, an amateur thespian, died on 12 September 20X1. In his will he left shares with a market value of $500,000 to establish a new charitable trust for the support of out-of-work actors and musicians. The trust was set up on 3 September 20X2 and registered as a charitable entity on 22 October 20X2, at which date the shares were transferred to the trust. Assuming a standard balance date, the income derived by the executor of Arthur’s estate from the shares between 12 September 20X1 and 22 October 20X2 will be exempt under s CW 36.

Inland Revenue’s approach is generally as follows:
(a) Specific legacies: When the legacy or devise is of a specific nominated asset it is usually apparent whether that asset directly produces income (eg company shares, a block of flats, a house property, a motor car, or a stamp or art collection). When the asset gifted to the charity produces income in the estate before the estate is distributed, and that income is able to be segregated from other estate income, then that particular income is exempt. If the asset gifted does not produce any income, then this provision does not apply.

(b) General legacies: Where a general legacy of a sum of money is given to a charity, and even though at the date of death there is sufficient cash held to satisfy the payment of the legacy, it cannot be assumed that only interest will arise. In fact, there may be no interest at all. The cash liquidity may have been a temporary state (eg in an estate comprising a farming or non-farming business). Consequently, a full appraisal of the estate assets and income may be required to show that the funds represented by the income are held for the benefit of the charities concerned.

(c) Residual estate to charity: Where the estate is left to a charity subject to a prior life interest to some person (eg a surviving spouse or other dependant), it will generally be the case that the income arising each year is for the benefit of the life tenant and assessable [see Inland Revenue Technical Rulings Manual, 13.3.31].

150.40 Charitable purpose [s YA 1]
The expression “charitable purpose” [s YA 1] includes every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community.

A trust, society or institution has a charitable purpose if its purpose would satisfy the public benefit requirement apart from the fact that the beneficiaries of the trust, or the members of the society or institution, are related by blood.

A marae has a charitable purpose if the physical structure of the marae is situated on land that is a Maori reservation referred to in Te Ture Whenua Maori Act 1993 (Maori Land Act 1993) and the funds of the marae are used only for:
(a) The administration and maintenance of the land and the physical structure of the marae; and
(b) A purpose that is a charitable purpose as set out above.

(1) Case law
The New Zealand Council of Law Reporting’s principal function is the preparation and publication of the New Zealand Law Reports. It was held that the existence of the power to make grants to law societies for non-charitable purposes did not impair the Council’s conceded central charitable purpose of publishing the official law reports of New Zealand and therefore did not deprive it of its status as a charity: New Zealand Council of Law Reporting v Commissioner of Inland Revenue (1979) 3 TRNZ 93 (SC); Commissioner of Inland Revenue v New Zealand Council of Law Reporting (1981) 5 NZTC 61,053 (CA).

The Auckland Medical Aid Trust was formed to establish and maintain a comprehensive health service related to the human reproductive process (whether by means of contraception, sterilisation, abortion, or otherwise) and to educate the public in the facts of human reproduction. In the years with which the case was concerned the income of the trust was derived almost exclusively from providing abortion services. The High Court
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held that the services of the trust were available to a wide enough section of the public to be charitable, and that the dissemination of education and learning is a charitable purpose, and, accordingly, the trust was charitable. The trust had not acted illegally, and although its activities were the object of public controversy, it could not be found that the controversy had harmed the public: Auckland Medical Aid Trust v Commissioner of Inland Revenue (1979) 4 NZTC 61,404 (HC).

A trust set up to hold gaming licences and operate gaming machines, and later to invest in commercial property, was held by the High Court to be a charitable trust. The objects of the trust were charitable and the fact that lack of funds and delays in obtaining gaming machine licenses temporarily inhibited the trust from making distributions did not change its essential character. However, the Court found that the trust’s business income was not exempt from tax under s 61(27) of the ITA 1976 [now s CW 42] because the trustees were able to (and did) receive benefits from the trust’s business income and to influence the nature, amount and circumstances of the benefits received by virtue of their capacity as settlor and trustee: Commissioner of Inland Revenue v Dick (2001) 20 NZTC 17,396 (HC). The decision of the High Court was confirmed by the Court of Appeal in Dick v Commissioner of Inland Revenue (2002) 20 NZTC 17,961 (CA).

The Crown Forestry Rental Trust (“CFRT”) was established to hold rent collected from tenants of Crown Forest Land and to use the income generated from investing that rent to assist claimants making claims before the Waitangi Tribunal involving Crown Forest Land. If the Tribunal recommended that Crown Forest Land be returned to Maori ownership, the accumulated rents relating to that land were paid over to the successful Maori claimants. However, when the Tribunal recommended that particular land not be returned to Maori ownership, the accumulated rents relating to that land were paid to the Crown. The CFRT claimed that its income was exempt under s CB 4(1)(c) of the ITA 1994 [now s CW 41].

In the High Court, O’Regan J held that the trust had more than one purpose and that one of those purposes (the transfer of capital back to the Crown) was not charitable. Therefore, the trust was not entitled to the exemption under s CB 4(1)(c) of the ITA 1994 [now s CW 41]. The Court of Appeal held that the first limb of s CB 4(1)(c) of the ITA 1994 [now s CW 41(1)(a)] does not require that a trust be established for charitable purposes, merely that the income in question be received for charitable purposes in the sense that the trustees are not empowered to hold or apply it for any other purpose. The assistance provided by CFRT to claimants was a charitable purpose because there was a public benefit. The requirement to pay surplus rents to the Crown on winding up meant that the trust was not dedicated at all times exclusively for charitable purposes. For this reason, the CFRT was not entitled to an exemption under s CB 4(1)(c) of the ITA 1994 [s CW 41(1)(a)].

On appeal the Privy Council held that the CFRT was entitled to exemption under s CB 4(1)(c) of the ITA 1994 [now s CW 41(1)(a)]. The Privy Council agreed with the Court of Appeal that in order to qualify for an exemption from tax, it was not necessary that a trust be established for charitable purposes. However, it was sufficient that the trust funds are applied exclusively for charitable purposes. The fact that the ultimate trust was in favour of the Crown was the critical feature of the case. Insofar as the rental income was needed to assist Maori to prosecute their claims, it was devoted to charitable purposes and so exempt from tax, and insofar as it was not applied for such purposes, it remained beneficially the tax-exempt income of the Crown. The latter never came within the scope of income tax at all: Latimer v Commissioner of Inland Revenue (2004) 21 NZTC 18,478 (PC); Latimer v Commissioner of Inland Revenue (2002) 20 NZTC 17,737 (CA); Latimer v Commissioner of Inland Revenue [2002] 1 NZLR 535, (2001) 20 NZTC 17,311 (HC).


A trust for the encouragement of the playing of football or other games or sports is not a trust for charitable purposes in a UK case: Inland Revenue Commissioners v McMullen [1978] 1 All ER 230 (HL). This is likely to be the case in New Zealand, unless the objectives of the trust as they relate to sporting are incidental.
However, in New Zealand there is specific exemption from tax on the income of a club formed to promote amateur sport [s CW 46].

In Calder Construction Co Ltd v Commissioner of Inland Revenue [1963] NZLR 921 (SC), there was power in the memorandum given to the directors to set aside out of the profits such reserves as they deemed necessary for the needs and development of the company’s operations and it was immaterial that the whole of the income was not obliged to be paid over immediately to the charities. The company was entitled to the exemption because the resulting assets had ultimately to be applied for charitable purposes.

Where the funds of an employees’ health and relief fund were provided for the assistance of needy employees and their dependants, it was held that the trust was for the relief of poverty; the class of beneficiaries was sufficiently wide to constitute the public element which was necessary to make it charitable and, therefore, the trust was a charitable trust: Gibson v South American Stores Ltd [1949] 2 All ER 18 (CA).

A fund set up to provide ministers of religion and their widows with financial security in retirement was exempt from tax under ss CB 4(1)(c) or CB 4(1)(e) of the ITA 1994 [now ss CW 41 or CW 42]. The income of the fund was held to be derived for charitable purposes: Presbyterian Church of New Zealand Beneficiary Fund v Commissioner of Inland Revenue (1994) 16 NZTC 11,185 (HC).

In Travis Trust v Charities Commission (2009) 24 NZTC 23,273 (HC) the Travis Trust appealed against a decision by the Charities Commission not to register it as a charitable entity under the Charities Act 2005. The trust was established to provide funds to support the New Zealand racing industry by sponsoring a horse race, and in fact the entire income of the trust had been applied as prize money for the race. The main beneficiary of the trust was the Cambridge Jockey Club Inc. The issue before the Court was whether the provision of prize money for a horse race is a charitable purpose. Joseph Williams J, in the High Court, held that the promotion of a horse race is not a charitable purpose in and of itself, nor is the promotion of horse racing generally. In his judgment, Joseph Williams J stated (at [59]):

“A trust to promote racing could only be charitable in nature if its deeper purpose was the pursuit of some other objective, either in principle or, in accordance with charities jurisprudence, a charitable purpose in its own right within the spirit and intendment of the Statute of Elizabeth. Thus, if it could have been established that the true intention of the support for this race was the promotion of health, education or perhaps even animal welfare, it might have satisfied the test.”

A jockey club is not the community or a sufficient section of it to amount to “the public”. The Charities Commission was correct not to register the trust as a charitable entity.

The High Court confirmed the Charities Commission’s decision to deny charitable status to the Grand Lodge of Antient Free and Accepted Masons in New Zealand, despite it holding charitable status for more than 50 years. The Grand Lodge was unable to show that all of its purposes were charitable. Under its constitution, all of its funds could be applied towards purposes that were not charitable. The purposes of freemasonry do not meet the requirements of a charity because it existed primarily for its members, and membership was limited to men over 21 years of age: Re the Grand Lodge of Antient Free and Accepted Masons in New Zealand HC Wellington CIV-2009-485-2633, 23 September 2010.

A trust established to protect and promote democracy and natural justice in New Zealand was held not to be a charity because its purposes were not exclusively charitable. The non-charitable purposes in its trust deed were not ancillary to its charitable purpose, and a significant part of the material published on its websites was partisan rather than educational: Re Draco Foundation (NZ) Charitable Trust CIV 2010-485-1275, 15 February 2011.

The New Zealand Computer Society Inc was held not to be a charitable entity because its purposes were not exclusively charitable. The society’s non-charitable purposes aimed at benefiting the profession are not ancillary to the purpose of advancing information technology as a discipline. Its professional society (non-charitable) functions constitute an independent purpose, and they are not ancillary to the learned society (charitable) functions: Re New Zealand Computer Society Inc CIV 2010-485-924, 28 February 2011.

In Re Greenpeace of New Zealand Incorporated [2011] NZHC 77, Heath J ruled that the Charities Commission was correct in holding that non-violent, but potentially illegal activities such as trespass,
designed to put (in the eyes of Greenpeace) objectionable activities into the public spotlight were an independent and non-charitable objective disqualifying it from registration as a charitable entity. The charitable purposes of Greenpeace could be met without resort to the type of political activities that deny its right to registration. The extent to which Greenpeace relies on its political activities to advance its causes means that the political element cannot be regarded as “merely ancillary” to Greenpeace’s charitable purposes. The political activities are an independent purpose – they are not necessary to educate members of the public on the issues of concern to Greenpeace.

The case Liberty Trust v Charities Commission, HC Wellington CIV 2010-485-000831, 2 June 2011 considered the issues of when an activity advances religion and when it meets the public benefit test. The Liberty Trust was established in 1989 for charitable purposes and was registered as a charitable entity under the Charities Act 2005 in 2007. The principal activity of the Trust is a mortgage lending scheme, funded mainly by donations, which makes interest-free loans to donors and others. The Trust contended that the lending scheme advances religion by teaching, through action, financial principles derived from the Bible. The Charities Commission reviewed the Trust’s charitable status and formed the view that the main purpose of the Trust, through its lending scheme, was to provide private benefits to members. The Commission considered that, at best, the lending scheme was conducive to religion but did not advance religion. The issues on appeal to the High Court were: (a) whether Liberty Trust “advances” religion, and (b) whether it meets the “public” benefit test.

On the first point, the Court held that the Charities Commission erred in finding that Liberty Trust does not have a charitable purpose as its main purpose. The Trust was set up to advance religion, which it seeks to do by teaching financial principles that it proclaims are the Bible’s financial principles. It seeks to teach those principles through providing a scheme which allows its followers (and anyone else who wishes to join up) to pool financial resources for the benefit of themselves and others. The religious beliefs upon which this scheme is based are reinforced by literature promoting the scheme and the Trust’s other publications and teaching activities. It is not merely inspired by or conducive to religion. Its purpose, through this scheme, is to spread what is viewed as being the Bible’s message.

On the second point, the Court held that the Charities Commission also erred in finding that Liberty Trust’s activities do not exist for the public benefit. As a trust which has as its purpose the advancement of religion, the starting assumption is that it has a public benefit. The activities are not contended to be subversive to morality or a sham. It is not for the Court to impose its own views as to the religious beliefs that are advanced through the scheme. The benefits of the scheme are not focussed too narrowly on the religion’s adherents. It is open to anyone and the money donated is “recycled” for the benefit of others.

On the basis of these findings, Mellor J allowed the Trust’s appeal and ordered that it be reinstated to the Charities Register.

150.50 Registration of charities [Charities Act 2005]

The Charities Commission (the “Commission”) was established on 1 July 2005 under the Charities Act 2005. The Commission’s main functions are to establish and maintain a registration and monitoring system for charitable organisations (the “Charities Register”); and to support and educate the charitable sector on good governance and management.

Although registration is not compulsory, charities are not able to claim exemption from income tax [see 150.10 to 150.30] or gift duty [see 315.20] unless they are registered as charitable entities under the Charities Act 2005. This includes charitable trusts and incorporated societies.

The function of registering donee organisations for the purposes of personal tax credits under ss LD 1 to LD 3 remains with Inland Revenue. Apart from tax-exempt status, the other advantage of being registered is that the charitable organisation will receive a registration number that can be displayed on its promotional material. This will give the public confidence that the organisation is a genuine charity.

An organisation can register as a charitable entity if:

(a) It is established and maintained for charitable purposes;
(b) It is not for the private profit of any individual or group;
(c) It has a name that complies with the Charities Act 2005; and
(d) All the officers of the charitable organisation are qualified to be officers.

The Commission will adopt the common law test for “charitable purposes”. This test requires the organisation to have a purpose that:
(a) Advances education;
(b) Advances religion;
(c) Relieves poverty; or
(d) Is otherwise beneficial to the community.

The charitable organisation’s object (purpose) must be to benefit the public. If the organisation has a secondary or supplementary non-charitable function (ie advocacy), this will not necessarily disqualify it from registering: *Travis Trust v Charities Commission* (2009) 24 NZTC 23,273 (HC) [see 150.40].

In *Canterbury Development Corporation v Charities Commission* (2010) 24 NZTC 24,143 (HC) the High Court (Ronald Young J) held that the Canterbury Development Corporation and its associated entities were unable to register as charities under the Charities Act 2005 because their main purposes were not charitable. Their main purposes were to assist individual businesses to develop and to improve the general economic wellbeing of the Canterbury region. The charitable aims stated in the Corporation’s constitution were ancillary to its main purposes.

The Charities Act 2005 does not provide for separate registration of businesses carried on by or on behalf of charities. A business that is carried on by a separate legal entity from the charity cannot itself register as a charitable entity unless it meets the general charitable purposes tests in its own right. A non-registered business would need to meet the requirements of s CW 42 for its income to be exempt from income tax. A registered charitable entity that derives business income in its own right must also meet the requirements of s CW 42 in order for its income to be exempt [see TIB vol 17:7 (September 2005) at 60].

Registration is not compulsory and there is no fee for registering.

All registered charities must complete an annual return. Charitable organisations with gross annual income of more than $10,000 must pay an annual return filing fee of $50 (on-line), or $75 (paper).

Inland Revenue and the Charities Commission work together to provide information on the tax status of charitable entities [see 150.55].

1) Further information

For further information on registration, see the Charities Commission’s website: www.charities.govt.nz.

150.55 Interaction of tax and charities rules

Inland Revenue’s operational statement on how the Charities Commission (the “Commission”) and Inland Revenue will monitor and advise charitable entities of the requirements for income tax and gift duty exemptions and donee status, following the opening of the charities register on 1 February 2007, is set out in TIB vol 18:11 (December 2006) at 23-30.

A working protocol has been agreed between Inland Revenue and the Commission through which entities that register as charitable entities under the Charities Act 2005 will also be advised of the requirements for the charities tax exemptions.

The following is a summary of Inland Revenue’s operational practice from 1 February 2007:

(a) Entities (other than council-controlled organisations) with non-business income that are registered with the Commission will prima facie qualify for the income tax exemption in respect of that income;

(b) For entities that derive business income, registration alone will not be sufficient for the business income tax exemption and they must self assess the extent to which their charitable purposes are carried out in New Zealand. This is because the s CW 42 exemption requires more than simply charitable status — the exemption only applies to income applied for charitable purposes within New Zealand.
Zealand, and it does not apply if individuals are able to benefit personally from the business [see 150.20];

(c) Entities that currently enjoy income tax exemption should register with the Commission by 1 July 2008. Failure to do so will result in the loss of their tax exempt status until they are subsequently registered;

(d) The CIR’s approval is required for donee status whether or not the entity is registered as a charity. Entities currently (ie pre-1 July 2008) listed as donee organisations will continue to enjoy donee status even though they may decide not to register with the Commission;

(e) Newly registered charities will generally not need to make separate application to Inland Revenue for donee status. If the charity indicated on its application for charitable status that it receives donation income, Inland Revenue will automatically check whether the requirements of s LD 3(2) and sch 32 have been met before granting donee status;

(f) Organisations that choose not to become registered charitable entities (eg because their purposes are benevolent, philanthropic or cultural rather than charitable) may still apply to Inland Revenue for approval as donee organisations;

(g) During the transitional period (from 1 February 2007 to 30 June 2008) charities will retain their existing tax exempt status for income tax, gift duty and resident withholding tax;

(h) The exemption from gift duty for gifts to charitable trusts, societies and institutions will cease from 1 July 2008 where the entities have not registered with the Commission;

(i) From 1 July 2008 Inland Revenue will not issue certificates of exemption from resident withholding tax to charitable entities unless they are registered with the Commission. Charitable entities must continue to apply to Inland Revenue for certificates of exemption;

(j) Charitable organisations are still required to have IRD numbers;

(k) After 30 June 2008 Inland Revenue will attempt to contact charitable organisations that its records show have an exemption from income tax, and have not registered with the Charities Commission, to determine their position; and

(l) In the past Inland Revenue has suggested that entities include restrictions in their rules preventing them from altering certain clauses without prior approval. Inland Revenue strongly recommends that organisations remove any requirement in their rules for Inland Revenue to consent to rule changes. To enable this to happen, Inland Revenue has given blanket consent to an amendment removing any such rule.

150.60 Reimbursement of volunteers [ss CO 1, CW 62B]

The general position is that payments to volunteers are income [s CO 1]. However, a payment is exempt if it reimburses actual expenses incurred by a volunteer in undertaking voluntary work [s CW 62B].

The person or organisation making the payment may estimate the expenditure likely to be incurred by a volunteer and the estimate, provided it is reasonable, is treated as the exempt amount.

The exemption also applies to reimbursements in non-cash form, such as petrol vouchers, and transport costs incurred in getting to and from the place of volunteering.

For the purposes of the exemption, a “volunteer” is a person who freely undertakes, in New Zealand, an activity:

(a) That was chosen by the volunteer or by a group of which they are a member;

(b) That provides a benefit to a community or another person; and

(c) For which there is no purpose or intention of private pecuniary profit for the volunteer.

If a payment to a volunteer exceeds the actual expenditure incurred, the person making the payment must treat the excess as an honorarium. An honorarium is a schedular payment, which is subject to the PAYE rules. Tax must be deducted from honoraria at the rate of 33 per cent [sch 4, Part B, cl 1]. The person making
the payment may apply to the CIR for a determination under s RD 8(3) of the amount or proportion of a payment that is expenditure incurred in deriving the payment. A determination made by the CIR under s RD 8(3) [see 1320.40] modifies the amount of expenditure that is exempt under s CW 62B.

For these purposes, an honorarium is an amount that a person receives for providing services:

(a) That is paid at a rate that is less than the market rate for the services; and
(b) For which, in the normal course, no payment is fixed for the services provided.

The exemption applies whether or not the reimbursement is paid in a lump sum or in multiple sums, and whether or not the amount is paid during an income year or at the end of an income year.

150.70 Overseas donee status [s LD 3(1), sch 32]

Generally, charitable organisations are only approved as donee organisations if their funds are used wholly or mainly for charitable, benevolent, philanthropic or cultural purposes within New Zealand [s LD 3(2)(a)]. However, an organisation that applies its funds mainly outside New Zealand may still become a donee organisation by applying for listing in sch 32 [s LD 3(1)(a)]. This is done by seeking Parliamentary approval. Application is made to Inland Revenue, which makes a recommendation to Government.

Cabinet will only consider including organisations in sch 32 if their funds are principally applied towards:

(a) The relief of poverty, hunger, sickness or the ravages of war or natural disaster;
(b) The economy of developing countries (recognised as such by the United Nations); or
(c) Raising the educational standards of a developing country.

Charities formed for the principal purpose of fostering or administering any religion, cult or political creed are specifically excluded.

Applications for inclusion in sch 32 should include:

(a) An indication of the amount of donations likely to be received each year;
(b) An indication of the proportion of annual income which is likely to be applied to charitable purposes outside New Zealand; and
(c) Any other information which the applicant would like used to support their case [Operational statement 06/02, TIB vol 18:11 (December 2006), at 29-30].

(1) Cabinet criteria

The following guidelines were released by the Government on 9 December 2009 to provide greater guidance to organisations seeking charitable donee status for their overseas activities. They are intended to be an interim measure only, to be followed in 2010 by a review of the Cabinet guidelines and the process for adding organisations to sch 32.

Organisations seeking overseas donee status must be credible, transparent and accountable, and their activities must be ones that the Government would want to support, being mindful that tax credits should not be available where donations are made to an organisation if there is a risk of private benefit or other misuse.

A number of questions are asked of these organisations. The responses to any of these questions may not necessarily be determinative.

(a) Types of organisations

The following questions help to clarify the types of organisations that the Government may consider for inclusion in sch 32.

Key questions include:

• Is the organisation carried on for any private pecuniary profit of an individual?
• In the event that the organisation winds up, does it distribute funds to charitable purposes (consistent with the Cabinet criteria) within New Zealand or to those organisations already listed in sch 32?
• Is the organisation registered as a charity with the Charities Commission?
• Does the organisation have an IRD number?
• Is the organisation established in New Zealand or does it have a very strong connection to New Zealand?

(b) **Credibility and sustainability of the organisation**

The following questions help to determine whether an organisation is credible and sustainable. Organisations should have robust internal management and potential longevity.

Key questions include:

• How long has the organisation been operating?
• What are its sources of funding (if any)?
• What is the manner of operation? (for example, business plans and finances).
• Who are the recipients of the funds raised in New Zealand?
• Are the funds derived from donations in New Zealand held and used prudently? (For example, do the funds achieve the purpose that was the reason for the donation and, as much as is possible, are they used for this purpose?) Ideally, at all times, the organisation should account for funds received from donations and clearly evidence a commitment to ensuring that funds are used to support the purpose, and are not diverted into unnecessary administration and management.
• Are its founding documents (such as a constitution or trust deed) and formal documents (such as annual plans and reports) and the activities of the organisation, consistent with the Cabinet criteria?

(c) **Project management and financial systems**

The following questions help to verify the adequacy of an organisation’s project management and financial systems. Organisations should be aware that there are a number of risks involved when charities are operating internationally. Examples of risks include political, personal, financial loss, and regulatory compliance risks. Adequate checks and balances for its project management and financial systems are necessary so that taxpayer funds are used appropriately.

Key questions include:

• Does the decision-making body of the organisation have relevant knowledge and experience of the relevant field, and other project and financial management systems? For example, is there a process for assessing, and monitoring projects and selecting beneficiaries?
• Does the organisation give funds to non-resident organisation(s)? If so, are the activities of the non-resident recipient(s) consistent with the Cabinet criteria?
• If the organisation works with non-resident organisation(s), does it have access to regular and accurate information from these organisation(s)?
• Does the organisation have a set of financial accounts that clearly identify receipts of donations and transfers of funds, on a regular basis, to its designated charitable purposes?
• Can the organisation demonstrate that its activities are likely to be effective in the long term?

(d) **Internal controls for regulatory compliance**

The following questions help to assess whether the tax relief afforded by overseas donee status is targeted appropriately, and that the associated tax benefits and entitlements are not abused.

Key questions include:

• Does the organisation have procedures to prevent funds going directly, or indirectly, to individual(s) for private pecuniary benefit?
• Does the organisation have procedures to prevent funds going directly, or indirectly, to individual(s) or organisation(s) associated with terrorism?
• Does the organisation have procedures to ensure that no support is given to any individual(s) or organisation(s) that may carry out activities that could result in conviction in New Zealand under the law, such as the Crimes Act 1961, or similar laws in the relevant country?

(e) **Ongoing requirements**

The Government has an expectation that organisations included in sch 32 will maintain adequate systems that can produce:
• Accurate information about project progress and activities;
• Adequate financial reports;
• Information about donations receipts that have been issued with correct details of funds received from its donors; and
• Other particulars as may be required by Inland Revenue in respect of the organisation’s activities, funding and finances.
## Chapter 160

### Child Support

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### 160.10 Purpose [CSA, s 4]

The purpose of the Child Support Act 1991 (CSA) is to assess the minimum level of financial support payable by certain parents in respect of their children, and to provide for the collection and payment of child support and spousal maintenance. In basic terms, the CSA requires parents who do not live with their children to pay financial support to the person who is responsible for the day-to-day care of them.

The specific aims of the CSA [s 4] are:
To affirm the right of children to be maintained by their parents;

(b) To affirm the obligation of parents to maintain their children;

(c) To affirm the right of caregivers of children to receive financial support for those children from non-custodial parents;

(d) To provide that the level of financial support to be provided by parents for their children is to be determined according to their capacity to provide financial support;

(e) To ensure parents with a like capacity to provide financial support for their children should provide like amounts of financial support;

(f) To provide legislatively fixed standards in accordance with which the level of financial support to be provided by parents for their children should be determined;

(g) To enable caregivers of children to receive support for those children from parents without the need to resort to Court proceedings;

(h) To ensure equity exists between custodial and non-custodial parents for the costs of supporting children;

(i) To ensure obligations to birth and adopted children are not extinguished by obligations to step-children;

(j) To ensure the costs to the State of providing an adequate level of financial support for children and their custodians is offset by the collection of a fair contribution from non-custodial parents; and

(k) To provide a system whereby child support and domestic maintenance payments can be collected by the Crown and paid by the Crown to those entitled to the money.

Parents liable to pay child support [CSA, s 6]

A person who is a parent of a qualifying child is liable to pay child support for that child if they are:

(a) A New Zealand citizen;

(b) Ordinarily resident in New Zealand; or

(c) Ordinarily resident in a country with which New Zealand has entered into a reciprocal agreement for the enforcement of child support.

However, child support will be payable only if the parent is not living with the eligible custodian [see 160.30].

A person is “ordinarily resident” in New Zealand if they meet the definition of a resident in the ITA 2007 [see 1250 RESIDENCE; CSA, s 218].

Meaning of parent [CSA, ss 7, 7A]

For child support purposes, a person is a parent of a child if:

(a) The person’s name is entered in the Register of Births in New Zealand, or an equivalent overseas register, as a parent of the child;

(b) The person is or was a party to a legal marriage and the child was conceived by or born to the person, or the other party to the marriage, during that marriage;

(c) The person adopted the child and that adoption order has not been discharged;

(d) A New Zealand or overseas court has ruled that the person is a parent of the child, and the finding has not been cancelled or set aside;

(e) The person has, in any New Zealand or overseas court proceeding, or in writing signed by the person, acknowledged that he or she is a parent of the child;

(f) A court has, under the Family Proceedings Act 1980, made a paternity order against the person in respect of the child;

(g) The person is the natural mother of the child;
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(h) The person has been declared to be a step-parent of the child by a Family Court; or
(i) A New Zealand or overseas court has appointed the person to be a guardian of the child, or has declared the person to be a guardian of the child, by reason of being the father of the child, and that appointment has not been cancelled or set aside.

However, if the CIR is satisfied (upon reviewing relevant evidence) that a person is not a parent of a particular child and has not been declared to be a step-parent of the child under s 99 of the CSA, then the person is not a parent of the child for child support purposes. A sperm donor is not a parent for child support purposes, unless the donor adopts the child.

The CIR may disregard either of the following if the CIR is not satisfied that the document is valid and authentic:

(a) A document purporting to be the original or a copy of a certificate, entry or record of a birth, death or marriage alleged to have taken place in an overseas jurisdiction; or
(b) A document purporting to be the original or a copy of an order or decree made by a court or public authority of an overseas jurisdiction.

160.25 Qualifying child [CSA, s 5]

Child support is payable only in respect of a qualifying child. A “qualifying child” is defined as any child:

(a) Under 19 years of age;
(b) Not living with another person in a marriage, civil union or de facto relationship;
(c) Not financially independent; and
(d) Who is a New Zealand citizen or ordinarily resident in New Zealand.

A person is “financially independent” if they are:

(a) Working as an employee or a self-employed person for at least 30 hours a week on average;
(b) Receiving a student allowance (basic grant or independent circumstances grant);
(c) Receiving a social security benefit; or
(d) Receiving a payment, under a Government-assisted scheme, that is equivalent to a social security benefit [CSA, s 2].

160.30 Custodial parent may apply for child support [CSA, s 8]

A person who is the eligible custodian of a qualifying child may apply for child support to be paid by a parent of the child. The eligible custodian may be the other parent or another person who is responsible for the care of the child (eg an adoptive parent).

An “eligible custodian” of a child is a person who is:

(a) The sole or principal provider of ongoing daily care for the child, or shares ongoing daily care of the child substantially equally with another person [see 160.40]; and
(b) Is not living with the person from whom payment of child support is sought in a marriage, civil union or de facto relationship.

If two or more people living together are both eligible custodians (as defined above) in relation to a child, only one of them may be the eligible custodian for child support purposes. If one of those persons is a parent of the child, that parent is the eligible custodian. The non-custodial parent may apply to pay child support if he/she is not living with the custodial parent [CSA, s 10].

160.35 Custodial parent receiving benefit [CSA, s 9]

A person who is the eligible custodian of a qualifying child must apply for child support if they are receiving a social security benefit. The application must be made at the same time as the application for the social security benefit is made. This is because child support collected from the liable parent is payable to the
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Government to offset the cost of the benefit. If the amount of child support exceeds the benefit, the excess is paid to the eligible custodian.

If a sole parent refuses to make an application for child support or to identify who the other parent of a child is, the rate of benefit is reduced by $22 per week. The benefit is reduced by a further $6 per week after 13 weeks if the sole parent has still not made an application for child support or identified who the other parent of a child is. Certain exceptions apply, for example, if there is insufficient evidence to establish who the other parent is, if the person or their children would be at risk of violence if the other parent were named, or if the child was conceived as a result of incest or sexual violation [Social Security Act 1964, s 70A].

A “social security benefit” [CSA, s 2] is:

(a) A domestic purposes benefit;
(b) An unsupported child’s benefit;
(c) Where the person is a sole parent:
   (i) A widow’s benefit;
   (ii) An invalid’s benefit;
   (iii) An unemployment benefit;
   (iv) A sickness benefit;
   (v) An emergency benefit.

160.40 Principal provider of childcare [CSA, ss 11, 12, 13]

In determining who the eligible custodian of a child is [see 160.30], the person who has the greatest responsibility for a child is the person who is the principal provider of ongoing daily care. If there is disagreement as to who the principal provider of ongoing daily care is, the decision is made by WINZ. If WINZ has not made a ruling the CIR decides who the principal provider of ongoing daily care is, having regard primarily to the periods the child is in the care of each person and then to the following factors:

(a) How the responsibility for decisions about the daily activities of the child is shared;
(b) Who is responsible for taking the child to and from school and supervising the child’s leisure activities;
(c) How decisions about the education or health of the child are made;
(d) The financial arrangements for the child’s material support; and
(e) Which parent pays for which expenses of the child.

If one person is the principal provider of ongoing daily care for a child and another person has care of the child for at least 40 per cent of the nights in a year, the second person is to be taken to share ongoing daily care substantially equally with the first person.

160.45 Liability for child support [CSA, ss 18, 19, 20]

If the CIR accepts an application for child support, child support is payable under a formula assessment by the liable parent from the date on which the CIR received the application. If the application is declined because it has not been properly made, child support is payable from the day the application is properly made.

Any voluntary agreement between the custodian and the liable parent for the payment of financial support is suspended as long as child support is payable under a formula assessment [see 160.60].

160.50 Assessments and objections [CSA, ss 24, 90-96, Part 6]

(1) Assessments

As soon as practicable after approving an application, the CIR must assess the amount of child support payable by the liable parent. An assessment must be made for the year of application and each subsequent child support year (a year ending on 31 March) [CSA, s 24].
A person who has been assessed for child support or domestic maintenance may object to an assessment only on the following grounds:

(a) The amount taken by the CIR to be the liable parent’s income is incorrect;
(b) The annual or monthly rate of financial support specified in the assessment has been incorrectly calculated;
(c) The assessment incorrectly specifies the days for which financial support is payable;
(d) The annual rate of financial support specified in the assessment is not correctly assessed [CSA, s 91].

(2) Objections
An objection must be posted or delivered to the CIR within 28 days of the date of the notice of assessment. The CIR has the discretion to accept a late objection. The notice of objection must state fully and in detail the grounds of the objection [CSA, s 92]. As soon as practicable, the CIR must notify the objector:

(a) Whether the objection has been allowed or disallowed;
(b) If the objection has been allowed, the effect of allowing the objection;
(c) If the objection has been disallowed, that the objector can appeal the decision to a Family Court [CSA, s 93].

The objector must pay financial support assessed pending the outcome of the objection. An exception applies if the objector has appealed to a Family Court against a decision by the CIR to accept an application for child support, on the grounds that the objector is not a parent of the child. In this situation, no payment of financial support will be required until there is a final decision of a Court [CSA, s 95].

(3) Inland Revenue policy on acceptance of late objections
Inland Revenue’s policy on accepting late objections to child support assessments or decisions under s 92(2) of the CSA is set out in SPS 10/03 [TIB vol 22:7 (August 2010), at 61-63]. Inland Revenue’s practice is based on the Court of Appeal decision in Commissioner of Inland Revenue v Wilson (1996) 17 NZTC 12,512 (CA), which suggested a two-step approach to considering late objection requests.

Step 1: Consider the reasons given by the objector for their failure to make a timely objection. A reasonable explanation for the delay is all that is required at this point. For example, where the delay was caused by the ill health of the objector or other circumstances beyond their control (such as being overseas for the whole of the 28-day objection period and there being no arrangements in place to receive and deal with notices), this will be sufficient to satisfy step 1. If the failure is due to inadvertence, negligence, an agent’s action or a deliberate decision of the objector, the request is likely to be declined.

Step 2: If the reasons given by the objector for the late objection are considered reasonable, the CIR will then consider all the circumstances surrounding the objection to decide whether, as a matter of fairness, the objection should be allowed.

Factors that support the acceptance of a late objection are:

- When the proposed objection has merit.
- When the objector has consistently asserted their entitlement and only failed to lodge an objection because of the CIR’s insistence that the entitlement was not available to them.
- When there are no practical or administrative difficulties in considering the situation at that time.
- When the objector has been told that a test case could apply to them.
- When an assessment notice or decision has been sent to the objector’s home and the objector is temporarily away during the 28-day objection period.
- The serious ill health or death of an agent, or the agent’s office is shut for the annual holidays.
- When granting the relief requested would not violate the CIR’s responsibility to be even-handed.
- When the objector is seeking legal or other professional advice.
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- When the objector is ignorant of procedures to follow.
- When the objector has fallen ill.

Factors that support declining a late objection are:

- If an objector has a professional adviser, Inland Revenue may be reluctant to accept a late objection because the advisor should be aware of the legislative requirements. Omitting to lodge an application because of an oversight by the advisor will usually not, on its own, constitute satisfactory grounds for accepting a late objection.
- How late an objection is and any history of making late objections by either the objector or the agent.
- Where the objector had never contemplated seeking a benefit but had tried to take advantage of a subsequent change in the interpretation of the law (eg as a result of a subsequent court decision or the issue of a standard practice statement).

The above factors are guidelines only and are not exhaustive. All circumstances will be considered. Decision-makers should always remain open to the possibility of new factors arising in any case that may make it unfair not to accept the objection. The weight given to each factor is to be decided by the CIR on the circumstances of each case. Inland Revenue will document the factors taken into account, the weight that has been applied to each factor, the reasons for the decision, and the decision.

The need to ensure that an assessment is correct is an important factor in deciding whether to accept a late objection, but it is not necessarily the paramount consideration. Where there is a clear error in an assessment or decision, an amendment can be made under s 87 of the CSA. If the error can be established only after further investigation or consideration (and the error does not arise from a subsequent change in the interpretation of the law), the procedures set out in steps 1 and 2 will need to be followed. A liberal approach should be taken when considering such claims.

There is no right of appeal under the CSA where the CIR does not exercise his discretion to accept a late objection. However, the decision can be challenged by way of judicial review to the High Court.

Case law

In Re M (child support) (No 2) (1993) 15 NZTC 10,015 (HC), the High Court upheld the Family Court’s decision not to alter the CIR formula assessment where the income was insufficient to meet outgoings, and “special circumstances” did not apply. Expenditure on private health insurance, obtaining further academic qualifications, and belonging to a superannuation scheme, while arguably prudent and responsible, could not be given priority over the need to maintain a child: Commissioner of Inland Revenue v Blakely (1993) 15 NZTC 10,311 (HC).

Matters such as an unplanned pregnancy, lack of contact between the parents, and the father’s lack of involvement with the child have no relevance to economic considerations and should not be taken into account to determine whether special circumstances exist to make the application of the formula of an unjust and inequitable determination of financial support. These provide no grounds for departure from the formula assessment although the percentage was varied for a specified period: L v W (1994) 16 NZTC 11,279 (CA).

An interest-free loan made by a non-custodial parent to a custodial parent is not a ground on which a departure order from a formula assessment for child support can be granted: Commissioner of Inland Revenue v Johnston (1996) 17 NZTC 12,588 (HC).

In Hudson v Commissioner of Inland Revenue (1996) 17 NZTC 12,594 (HC), a non-custodial parent was required to continue paying child support to the custodial parent regardless of the fact that the child concerned boarded with another family for 11 months while the custodial parent was overseas. It was held that the custodial parent continued to be the principal provider of ongoing daily care despite her absence.

In D v C (2002) 20 NZTC 17,548, (2001) 15 PRNZ 474 (CA), both parents shared the custody of their three children equally. One of the parents had a much higher income than the other, and the lower income parent applied for a departure order on the basis that the formula assessment was insufficient to adequately support the children. The High Court made a departure order on the basis of the principle of proportionality of relative

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incomes. The Court of Appeal, in reaching a revised departure order, rejected the principle of proportionality adopted by the High Court and held that the higher income earner’s non-financial contribution also needed to be taken into account.

In *McBrearty v Peck* FC Christchurch FP009/906/01, 6 May 2002, the Family Court held that the use of inappropriate means to reduce or evade liability for child support may constitute special circumstances justifying the granting of a departure order. The liable parent had understated his income for income tax purposes by claiming deductions for non-deductible items. Consequently his family support liability was reduced. The Family Court, in granting a departure order, added back the false deductions to the liable parent’s income and increased his child support liability accordingly.

### 160.55 Termination of liability for child support [CSA, ss 25, 26, 27]

A parent’s liability to pay child support in respect of a child ends when the child turns 19, is adopted, marries, enters a civil union or de facto relationship, becomes financially independent, ceases to be a New Zealand citizen and ordinarily resident in New Zealand, or dies.

A person’s liability to pay child support also ends if the person:

1. Becomes the sole provider of ongoing daily care for the child;
2. Ceases to be a New Zealand citizen, ordinarily resident in New Zealand and ordinarily resident in a country with which New Zealand has entered into a reciprocal agreement;
3. Is determined by the CIR (under s 7(2) of the CSA) not to be a parent of the child;
4. Dies; or
5. Begins living with the eligible custodian in a marriage, civil union or de facto relationship.

If the eligible custodian dies, the liable parent’s liability to pay child support ceases 28 days after date of death unless a new application for child support is made for the child within 28 days. A person’s liability to pay child support also ends if the eligible custodian ceases to be the sole or principal provider of ongoing daily care for the child, or ceases to share ongoing daily care substantially equally with another person.

An eligible custodian who is not receiving a social security benefit may elect that the liability of a liable parent to pay child support end from a specified future date.

### 160.60 Basic amount of child support [CSA, ss 29, 30, 31, 32, 33]

The annual amount of child support payable by a liable parent is the greater of the minimum annual rate [see 160.80], or the amount (for the child support year), calculated using the following formula:

\[
(a - b) \times c
\]

Where:

- \(a\) is the liable parent’s child support income for the child support year [see 160.65];
- \(b\) is the living allowance to which the liable parent is entitled for the year [see 160.70];
- \(c\) is the child support percentage [see 160.75].

**Example:**

Jack and Jill have separated, with Jack living alone and Jill having custody of two children from their marriage. Jack’s taxable income for the year ended 31 March 2011 was $31,946. Jill is the custodian. Jack is the liable parent. Jack’s child support liability for the year ended 31 March 2012 is:

\[
($31,946 - $14,281) \times 24\% = $4,239.
\]

Income figures used in the formula do not include any income that Jack’s new partner (should he have one) may derive. It does not take into account Jack’s current level of income. Neither does it take account of any income which Jill might have derived while Jack and Jill were together, nor Jill’s current level of income.

Where a parent is liable to pay child support to two eligible custodians who share the ongoing daily care of a child, the amount of child support payable to each custodian is 50 per cent of the amount calculated under the above formula.
160.65 Child support income [CSA, s 38, 39, 39A]

(1) Income consists only of withholding income

If the liable parent’s income is derived solely from withholding income (employment income subject to PAYE, and interest and dividends subject to RWT), their child support income is their taxable income for the most recent tax year. Because child support assessments are issued before the end of the tax year (to allow liable parents time to object), actual taxable income for the 10 months to the end of January may be grossed up by Inland Revenue to an annual income amount. No inflation adjustment is made. When the full annual income amounts are known, Inland Revenue will reassess the liability if the final taxable income amount is at least $500 more or less than the estimated taxable income.

(2) Income from sources other than withholding income

If the liable parent’s income is derived from any source other than withholding income, their child support income is their taxable income for the tax year immediately preceding the most recent tax year, increased by the CPI for the calendar year preceding the child support year. Thus a person’s child support liability for the year ended 31 March 2011 will be based on their inflation adjusted taxable income for the year ended 31 March 2009.

If the liable parent is resident in a country outside New Zealand the CIR may, in calculating the liable parent’s child support liability, take into account any income derived in and taxable in that other country [CSA, s 39A].

(3) Maximum child support income

Child support income cannot exceed the following maximum:

<table>
<thead>
<tr>
<th>Year ended</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 March 2010</td>
<td>$114,191</td>
</tr>
<tr>
<td>31 March 2011</td>
<td>$120,463</td>
</tr>
<tr>
<td>31 March 2012</td>
<td>$121,833</td>
</tr>
</tbody>
</table>

If actual taxable income for a year exceeds the maximum, the liable parent’s child support income (item “a” in the calculation of child support [see 160.60]) is based on the maximum figure.

160.70 Living allowance [CSA, s 30]

The living allowance depends on the liable parent’s living circumstance and the number of dependent children they have, as follows:

<table>
<thead>
<tr>
<th>Living arrangement</th>
<th>Dependent children</th>
<th>Year ended</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>31 March 2010</td>
<td>31 March 2011</td>
</tr>
<tr>
<td>Single</td>
<td>0</td>
<td>$14,038</td>
</tr>
<tr>
<td>Married, civil union or de facto</td>
<td>0</td>
<td>$19,088</td>
</tr>
<tr>
<td>Single, married, civil union or de facto</td>
<td>1</td>
<td>$26,901</td>
</tr>
<tr>
<td>Single, married, civil union or de facto</td>
<td>2</td>
<td>$29,663</td>
</tr>
<tr>
<td>Single, married, civil union or de facto</td>
<td>3</td>
<td>$32,425</td>
</tr>
<tr>
<td>Single, married, civil union or de facto</td>
<td>4</td>
<td>$35,187</td>
</tr>
</tbody>
</table>

160.75 Child support percentage [CSA, s 29]

The child support percentage is based on the number of children for whom the liable parent is paying child support.
160.80 Minimum annual rate of child support [CSA, s 72]

The minimum annual amount of child support payable by a liable person, regardless of the number of children involved is outlined below.

<table>
<thead>
<tr>
<th>Year ended</th>
<th>Minimum annual amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 March 2008</td>
<td>$749</td>
</tr>
<tr>
<td>31 March 2009</td>
<td>$773</td>
</tr>
<tr>
<td>31 March 2010</td>
<td>$799</td>
</tr>
<tr>
<td>31 March 2011</td>
<td>$815</td>
</tr>
<tr>
<td>31 March 2012</td>
<td>$848</td>
</tr>
</tbody>
</table>

160.85 Split custody [CSA, s 34]

Split custody occurs when a parent of two or more qualifying children has ongoing daily care for one or more of those children and, at the same time, the other parent has the ongoing daily care of the other child or children. In this situation, each parent has a liability to pay child support to the other. However, one parent’s liability is offset against the other so that only the parent with the larger liability has to pay child support. This cannot be done where one or both of the parents is a social security beneficiary.

Example:
Bob and Penny (neither of whom is a social security beneficiary) have split custody of their children. If Bob has a child support liability of $3,024 and Penny has a liability of $4,293, the result is that Bob pays nothing and Penny pays $1,269.

160.90 Shared custody [CSA, s 35]

Shared custody occurs when the parents of qualifying children are living apart and each parent has the ongoing daily care of one or more of their children for at least 40 per cent of the time consistently during the year [see 160.40].

Shared custody affects the formula used to calculate the amount of child support. Both parents are treated as eligible custodians and liable persons. The percentage rate of each liable person’s income is reduced. Each child for whom custody is shared is counted as 0.5 of a child for the purposes of the child support percentage.

If the liable parent shares the care of the children with the custodian, the child support percentages are as follows:

<table>
<thead>
<tr>
<th>Number of children</th>
<th>Child support percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.5</td>
<td>12%</td>
</tr>
<tr>
<td>1</td>
<td>18%</td>
</tr>
<tr>
<td>1.5</td>
<td>21%</td>
</tr>
<tr>
<td>2</td>
<td>24%</td>
</tr>
<tr>
<td>2.5</td>
<td>25.5%</td>
</tr>
<tr>
<td>3</td>
<td>27%</td>
</tr>
</tbody>
</table>
**Number of children**  | **Child support percentage**
--- | ---
3.5 | 28.5%
4+ | 30%

**Example:**
Frank and Susan are divorced. They have three children, and each parent has full-time custody of one child each and shared custody of the third child. Frank’s taxable income for the previous year is $46,105 and Susan’s taxable income for the previous year is $36,328. Each parent is liable to pay the other for child support for 1.5 children. Their child support liabilities for the year ended 31 March 2012 are calculated as follows (calculations are rounded to the nearest dollar):

**Frank**
- Taxable income: $46,105
- Less living allowance: $30,558
- Balance: $15,547
- Multiplied by 21 per cent for 1.5 children: $3,265

**Susan**
- Taxable income: $36,328
- Less living allowance: $30,558
- Balance: $5,770
- Multiplied by 21 per cent for 1.5 children: $1,212

Provided neither parent is a social security beneficiary, the amounts can be offset with the result that Frank will pay Susan $2,053.

In *Andrews v Commissioner of Inland Revenue* [2003] NZFLR 193 (HC), the High Court found that a father who had night care of his children for 35 per cent of the time did not provide substantially equal care of his children. The Court emphasised that no arithmetical formula could be applied to the factors in s 12(b) of the CSA, and an assessment of overall care was necessary to decide whether there was substantially equal sharing.

**160.95 Child support based on estimated income** [CSA, ss 40, 41, 42, 43]
A liable parent may apply to the CIR to have their child support liability calculated on the basis of their estimated taxable income. This can be done only if the estimate is 85 per cent or less of the person’s taxable income for the last relevant tax year (as increased by the appropriate inflation factor, if applicable). The application must be given to the CIR before or during the child support year, and must be accompanied by information and evidence that is sufficient to support the estimate.

A child support liability based on estimated income takes effect from 1 April, if the election was made before 1 April. If the election was made after 1 April, the estimate takes effect from the first day of the month in which the election was made.

**Example:**
A liable parent’s taxable income for the year ended 31 March 20X1 was $46,759. Because of a change in his employment situation, his taxable income for the year ended 31 March 20X2 will be approximately $37,000. He obtains a letter from his employer confirming his expected earnings. On 24 March 20X1 he advises the CIR in writing that he wishes his child support liability to be based on his estimated income of $37,000 and includes a copy of the letter from his employer. Because the estimated income is 79 per cent of his taxable income from the previous tax year (ie less than 85 per cent), his child support liability for the year ended 31 March 20X2 will be based on his estimated income of $37,000.

A liable parent cannot apply to re-estimate their taxable income within three months of any previous estimate unless the new estimate exceeds the old estimate by at least $500. If a liable parent revokes their estimate, or no longer meets the threshold for estimating income, their child support liability will revert to what would have been payable had they not estimated.
160.100  End-of-year reconciliation following estimate [CSA, ss 44, 45]

If a liable parent’s child support liability for a year is based on estimated income then, following the end of the child support year, the CIR will complete an end-of-year reconciliation to ensure that the correct amount of child support has been paid. The amount of child support that should have been paid is the lesser of:

(a) The amount of child support based on the liable parent’s actual taxable income for the year; and

(b) The child support that would have been payable (under s 29 of the CSA) if the parent had not made an election.

If a liable parent who has estimated their income does not file an income tax return to enable Inland Revenue to make an end-of-year reconciliation, Inland Revenue will issue a reconciliation assessment for the amount that the liable parent would have been required to pay had they not estimated. The liable parent can object to this reconciliation only by filing a tax return within 28 days of receiving notification of the assessment. If they do not file a return within this period, the reconciliation stands. The liable parent will also be prevented from estimating again until they have filed their outstanding tax returns. All liable parents will have their liability capped at the amount they would have had to pay had they not estimated their income.

If child support based on an estimate is less than 80 per cent of the amount of child support that would have been payable if an estimate had not been made, the liable parent is liable for a penalty of 10 per cent of the difference.

Example:

A liable parent paid child support of $3,600 based on an estimate of income. Child support based on taxable income for the year was $6,000. A penalty of $240 [10 per cent of ($6,000 − $3,600)] will be charged on the underestimate. $3,600 is only 60 per cent of $6,000, ie less than 80 per cent.

160.105  Voluntary agreements [CSA, ss 47-66A, Part 3]

A liable person and an eligible custodian may make a voluntary written agreement at any time, setting out the amount the liable parent will pay to the custodian for the support of the children. It does not need to be registered in the Family Court. It may also be made where one person agrees to make a payment to support a former partner, even when no children are involved (domestic maintenance).

The parties to a voluntary agreement can have it administered by Inland Revenue provided the amount payable under the agreement is at least $10 per week. If the person receiving the payments is a social security beneficiary [see 160.35], the amount of support payable must be greater than the amount that would be calculated under a formula assessment [see 160.60].

If Inland Revenue accepts a voluntary agreement, the amount is paid direct to Inland Revenue, which then passes the amount in excess of what is due under the formula through to the eligible custodian, the balance being passed to the Government to offset the custodian’s social security benefit. If the liable person fails to pay, Inland Revenue follows up the non-payment as if it were a formula assessed payment that was owing. A voluntary agreement can be changed or withdrawn at any time, and either party can apply for a formula assessment at any time. The formula assessment will automatically override the voluntary agreement.

Court-ordered domestic maintenance is collected and enforced through Inland Revenue, although the recipient of the maintenance may choose not to have it collected by Inland Revenue.

160.110  Temporary exemptions [CSA, ss 89A-89ZE, Part 5A]

(1)  Long-term hospital patients [ss 89B, 89C, 89F, 89G, 89H]

A liable person is exempt from paying child support for the whole, or part, of a long-term period of hospitalisation if:

(a) The person’s income for the period is nil, or consists only of income from investments or a social security benefit at the rate applicable to long-term hospital patients [sch 22 of the Social Security Act 1964]; and
(b) The person’s income from investments (if any) during that period does not, on a weekly basis, exceed the minimum annual rate of child support [see 160.80].

A long-term period of hospitalisation is defined as a continuous period of 13 weeks or more during which the person is a hospital patient. A person seeking an exemption must apply for it within three months after the period of hospitalisation ends. An application for exemption may relate to the whole of the period of hospitalisation or to one or more parts of it.

(2) **Long-term prisoners [CSA, ss 89B, 89D, 89F, 89G, 89H]**

A liable person is exempt from paying child support for the whole, or part, of a long-term period of imprisonment if:

(a) The person’s income for the period is nil, or consists only of income from investments; and

(b) The person’s income from investments (if any) during that period does not, on a weekly basis, exceed the minimum annual rate of child support [see 160.80].

A long-term period of imprisonment is defined as a continuous period of 13 weeks or more during which the person is a prisoner. A person seeking an exemption must apply for it before the period of imprisonment ends. An application for exemption may relate to the whole of the period of imprisonment or to one or more parts of it.

(3) **Liable parents under the age of 16 [CSA, ss 89E, 89F, 89G, 89H]**

A liable person is exempt from paying child support if the person is under 16 years of age and:

(a) The person’s income for the period is nil, or consists only of income from investments; and

(b) The person’s income from investments (if any) during that period does not, on a weekly basis, exceed the minimum annual rate of child support [see 160.80].

A person seeking an exemption must apply for it within three months after the day on which the person turns 16. An application for exemption may relate to the whole of the period before the person turns 16 or to one or more parts of it.

(4) **No entitlement to refund [CSA, s 89J]**

If a liable person is exempted from paying child support during a long-term period of hospitalisation, long-term period of imprisonment, or before the person turns 16, the person is not entitled to a refund of any child support paid during the period of exemption. Instead of refunding the excess, the CIR may:

(a) Apply the excess to any unpaid child support or penalty;

(b) Hold the excess and apply it to any future child support liability; or

(c) Amend any assessment.

**Example:**

A liable person paying weekly child support of $75 goes into hospital. At the time he was admitted he did not know long he would be in hospital. After four weeks in hospital, he was advised by his doctor that he would have to remain in hospital for at least another three months. At this point, he applies for exemption from child support under s 89C of the CSA. The exemption is granted by the CIR two weeks later. By this time, the liable person has paid $450 in child support in relation to the exempt period. Inland Revenue cannot refund this overpayment, but it will be applied against any arrears of child support or penalties, or held and applied to any future child support liability.

160.115 **Exemption for victims of sex offences [CSA, ss 89Y-89ZE]**

A liable parent may be permanently exempted from paying child support in relation to a particular child if the liable parent is the victim of a sex offence and the child was conceived as a result of that offence. The period of exemption applies from the day the CIR accepts an application for formula assessment of child support for the child if:

(a) The application for formula assessment was made on or after the day the offender was convicted of the offence; and
(b) The liable parent (ie the victim of the sex offence) applied for the exemption within 28 days after the CIR notified the liable parent that the application for formula assessment had been accepted. Otherwise, the period of exemption commences on the day the CIR receives the application. The CIR may obtain information from the Ministry of Justice and the New Zealand Police in order to determine whether the applicant is eligible for the exemption. If the conviction for the sex offence is subsequently quashed, any exemption granted is void from the start. If, following a retrial, a person is convicted of a sex offence, the victim may reapply for an exemption.

160.120 Payment by liable parents [CSA, ss 128-138, Part 8]

Child support that is payable is a debt due to the Crown. A person who is liable to pay child support may choose the method of payment. The available options are:

(a) Deductions from a benefit;
(b) Automatic payments from a bank account;
(c) Online payments;
(d) Payment by cheque to Inland Revenue;
(e) Payment by cash or cheque at any Westpac branch; or
(f) Deductions from salary or wages (if the liable person is in arrears).

However, if a liable person defaults in the payment of child support, Inland Revenue may require future payments to be made by automatic deduction from salary or wages, ACC payments, tax refunds or bank accounts [see 160.140]. If a liable person receives a social security benefit, payments of child support are deducted from the benefit.

Child support is payable on the 20th of the month following the month in which the liability arises. Thus child support calculated for the month of August is due for payment on 20 September. An exception applies to the first child support payment — in this case the payment is due on the later of the 20th of the following month or 30 days after the notice of assessment is issued.

160.125 Late payment penalty [CSA, s 134]

If a child support payment is not paid by the due date, a 10 per cent penalty (minimum $5) is added. For each additional month after the original due date that the amount owing, or any part of it, remains unpaid a further two per cent penalty is added. The 10 per cent penalty is referred to as the initial late payment penalty; the two per cent penalty is referred to as the incremental late payment penalty.

160.130 Relief from late payment penalties [CSA, ss 128-138, Part 8]

1. Discretionary relief [CSA, ss 135A-135G]

The CIR may grant relief from the whole or part of a late payment penalty in the following circumstances:

(a) There was a reasonable cause for the delay in payment of the debt and the default was remedied as soon as practicable. “Reasonable cause” means an event or circumstance beyond the control of the liable person, including a serious illness, accident or disaster, that caused the delay in payment [CSA, s 135B].

(b) The delay in payment was caused by a failure to make a deduction under Part 10 of the CSA (eg the failure of an employer to deduct child support from salary or wages) and the liable person has taken reasonable steps to mitigate the effect of that failure [CSA, s 135C].

(c) The delay in payment was due to an honest oversight by the liable person, who has no history of default, and the debt was paid as soon as the person became aware of the oversight [CSA, s 135D].

(d) The delay in payment was due to an error made by an officer of Inland Revenue, and the liable person acted in good faith and altered their position in reliance on the error [CSA, s 135E].
(e) The eligible custodian has uplifted the debt to which the penalty relates under s 180 of the CSA [CSA, s 135F]. Section 180 of the CSA allows the eligible custodian to elect that the CIR not pursue a child support debt.

(f) The CIR may grant relief from incremental penalties if the liable parent has paid all of the child support debt and initial late payment penalties, and the recovery of the incremental penalties would involve an inefficient use of the CIR’s resources and would place the liable person in serious hardship. The CIR must have regard to ss 6 and 6A of the TAA, which relate to the requirements to protect the integrity of the tax system and to collect over time the highest net revenue practicable [CSA, s 135G]. “Serious hardship” has a similar meaning to that in the financial relief provisions in the TAA [see 480.25].

(2) **Mandatory relief [CSA, ss 135H-135N]**

The CIR must write off an initial late payment penalty in the following circumstances:

(a) The penalty relates to the first payment of child support payable by the liable person and:

(i) Within three months of the date the assessment was issued, the person enters into an agreement with the CIR to pay their current and future child support by instalment, and all those instalments are paid in full and on time as per the agreement; or

(ii) Within three months of the date the assessment was issued, the CIR gives a person (eg an employer) a deduction notice under s 154 of the CSA for the purpose of collecting the liable person’s current and future child support by deduction, and all deductions are made as required [CSA, s 135H].

(b) The amount of the penalty is $5 or less, the amount of debt that the penalty relates to is less than the amount of the penalty, and the person has no history of defaulting on their child support payments. The CIR must refund any part of the penalty that has already been paid [CSA, s 135I].

The CIR must write off incremental penalties in the following circumstances:

(a) A liable person has entered into a payment agreement with the CIR on or after 25 September 2006 and has met all their obligations under the agreement up until a particular review date. A review date is six months after the agreement was entered into and every six months thereafter. The CIR must review the incremental penalties that were unpaid at the time the agreement was entered into and write off those penalties in proportion to the amount of the initial debt that has been paid during the past six months. The CIR must refund any part of a penalty written-off that has already been paid [CSA, s 135J]. In applying s 135J of the CSA, the CIR may disregard a failure to make a payment under the agreement if the failure was caused by the circumstances that entitle a person to relief under ss 135B to 135E of the CSA (ie reasonable cause for the delay, failure of a person to make a deduction, honest oversight, or error by an Inland Revenue officer) [CSA, s 135L].

(b) A liable person entered into a payment agreement with the CIR before 25 September 2006 and has met all their obligations under the agreement up until a particular review date; or the CIR has issued a deduction notice to a person (eg an employer) and that person has made all the deductions and payments required to be made up until a particular review date. A review date is six months after 25 September 2006 and every six months thereafter. The CIR must review the incremental penalties that were unpaid as at 25 September 2006 and write off those penalties in proportion to the amount of the initial debt that has been paid off since 25 September 2006. The CIR must refund any part of a penalty written-off that has already been paid [CSA, s 135K]. In applying s 135K of the CSA, the CIR may disregard a failure to make a payment under an agreement if the failure was caused by the circumstances that entitle a person to relief under ss 135B to 135E of the CSA (ie reasonable cause for the delay, failure of a person to make a deduction, honest oversight, or error by an Inland Revenue officer) [CSA, s 135L]. The CIR may also disregard a failure to make a deduction or payment in accordance with a deduction notice if the failure was caused by the circumstances that entitle a person to relief under ss 135B, 135C or 135E of the CSA [CSA, s 135L].
The incremental penalty relates to a child support debt that is payable in one or more instalments under a payment agreement, and all of the payments due under the agreement have been paid. The CIR must write off the incremental penalty. The CIR must refund any part of the penalty that has already been paid [CSA, s 135M].

The incremental penalty relates to a child support debt in respect of which deductions are required to be made under a deduction notice, and all of the deductions and payments required under the notice have been made. The CIR must write off the incremental penalty. The CIR must refund any part of the penalty that has already been paid [CSA, s 135N].

### 160.135 Payments to eligible custodians [CSA, ss 139-152A, Part 9]

If the eligible custodian is not a social security beneficiary, all payments of child support received by the CIR in respect of a qualifying child, whether under a formula assessment or a voluntary agreement, must be paid to the eligible custodian [CSA, s 141].

If the eligible custodian is a social security beneficiary, child support payments received by the CIR under a formula assessment are applied firstly in payment of the benefit and any balance remaining is paid to the eligible custodian [CSA, ss 142, 143]. All payments of domestic maintenance received by the CIR must be paid to the person in respect of whom they are paid [CSA, s 145].

Payments received by the CIR on or before the 20th of the month must be paid out to eligible custodians on or before the seventh day of the following month. The CIR is not required to pay out any amount less than S5 [CSA, s 146].

An amount of child support that has been deducted from money payable to a liable person (eg by an employer) but not paid to Inland Revenue by the 20th of the following month is deemed to have been received. Thus the eligible custodian will receive payment from Inland Revenue even though Inland Revenue has not yet received the amount [CSA, s 147].

All payments of child support by the CIR must be by direct credit to the payee’s nominated bank account [CSA, s 148].

### 160.140 Automatic deductions [CSA, ss 153-177, Part 10]

If child support is payable by automatic deduction [see 160.100] the CIR may issue a deduction notice to any person requiring them to make deductions from money payable to the liable person and to pay the amount of those deductions to Inland Revenue [CSA, s 154]. For example, the CIR can require that amounts be deducted by an employer from salary or wages, or by a bank from amounts on deposit. A copy of the deduction notice must be given to the liable person [CSA, s 156].

A deduction notice remains in force until revoked or until a new deduction notice is issued [CSA, s 158]. The person to whom the deduction notice is given (the “payer”) is obligated to make the required deduction, is deemed to be acting under the authority of the liable person, and is indemnified in respect of the deduction [CSA, ss 159, 162]. Deductions made under a deduction noticed during a month must be paid to Inland Revenue by the 20th of the following month [CSA, s 163].

Despite the requirements of the deduction notice, the amount deducted from employment earnings by an employer or PAYE intermediary must not exceed 40 per cent of the liable person’s net earnings (ie source deduction payment less PAYE) for the pay period. However, if the liable person has more than one employer and agrees, a deduction may exceed 40 per cent of the person’s net earnings from any one employer provided the total deductions from all sources of earnings for the pay period do not exceed 40 per cent of net earnings [CSA, s 166].

Automatic deductions of child support must be held in trust for the Crown and are not the property of the payer [CSA, s 167]. Where a payer has failed to make a required deduction, the amount constitutes a debt payable to the CIR and becomes a charge on the real and personal property of the payer [CSA, ss 168, 169]. A payer must keep a record of all amounts deducted from money payable to a liable person and keep those records for at least seven years [CSA, s 177].
160.145 Offences and penalties [CSA, ss 170, 171, 172, 208, 210]

It is an offence for a payer under Part 10 of the CSA, or a payer’s employee, to communicate any information regarding a liable person to any other person except for the purpose of performing the payer’s child support obligations [CSA, ss 170, 172]. The penalty is a fine of up to $15,000 for each offence for the first conviction and up to $25,000 for each offence for any subsequent conviction [CSA, s 210(2)].

It is also an offence for an employer to discriminate against an employee because of the fact that they are a liable person, or because the employer has received a deduction notice in relation to the liable person [CSA, s 171].

The following are also offences under the CSA:

(a) Failure by an exempted person to notify the CIR that they have received extra income that may affect their exemption;
(b) Making a deduction in excess of 40 per cent an employee’s net earnings;
(c) Failure by a liable person or a payee to notify the CIR of a change in their address or any change in circumstances required by the CIR to be notified;
(d) Knowingly providing the CIR with a false document, statement or declaration or false information;
(e) Intentionally misleading or attempting to mislead the CIR;
(f) Knowingly falsifying records;
(g) Obstructing an Inland Revenue officer;
(h) Aiding, abetting, inciting or conspiring with any person to commit any offence [CSA, s 208].

The penalty for the above listed offences [except (h)] is:

(a) A fine of up to $2,000 for each offence, on the first conviction;
(b) A fine of up to $4,000 for each offence, on the second conviction;
(c) A fine of up to $6,000 for each offence, on each subsequent conviction [CSA, s 210(3)].

The penalty for aiding and abetting is a fine not exceeding the maximum fine applying to the offence that the person aided, abetted, incited or conspired with [CSA, s 210(4)].

160.150 Refund of excess financial support [CSA, ss 216-240, Part 14]

A person who has paid more financial support than they are required to may apply to the CIR for the excess to be refunded, or to be transferred and credited against:

(a) Any tax liability of the person;
(b) Any tax liability another person;
(c) Another person’s financial support liability [CSA, ss 216, 216B].

The request for transfer must be in writing [CSA, s 216C].

If a person fails within 12 months to apply for a refund of an overpayment of $5 or less, the CIR must transfer the amount to the person’s income tax credit account [CSA, s 216(5)].

160.155 Reciprocal agreement with Australia

The Child Support (Reciprocal Agreement with Australia) Order 2000, which came into effect on 1 July 2000, allows the relevant agencies in Australia and New Zealand to enforce payment of child support and domestic maintenance owing to a custodial parent living in the other country, and to exchange information regarding liable parents’ income and addresses. The Order applies to formula based child support, voluntary arrangements and Court awarded child and domestic maintenance.

Each country uses its own debt collection procedures to enforce payment. According to Inland Revenue, this usually means requiring employers to make deductions from liable parents’ salary or wages [see TIB vol 12:6 (June 2000) at 9].
Existing arrangements that have been agreed to by the custodial parent and the liable parent are allowed to continue outside the reciprocal agreement.

**160.160 CIR’s practice on child support instalment arrangements**

Standard practice statement SPS 11/02 [TIB vol 23:2 (March 2011) at 17–23] sets out Inland Revenue’s practice on how the CIR’s discretion will be exercised when dealing with requests for instalment arrangements for the payment of overdue child support debt. The statement also explains how the CIR’s discretion with respect to the write-off of incremental penalties will be exercised. The statement is dated 16 February 2011.

Liable persons are encouraged to contact Inland Revenue at the earliest opportunity if they are not going to be able to pay their child support obligations on time and in full to discuss their options for payment, which may include an instalment arrangement.

Requests for an instalment arrangement may be made in writing, by telephone, or in any other manner acceptable to the CIR. For example, the Inland Revenue website on-line service may be used. Requests will be considered on a case-by-case basis. A liable person will need to show why they cannot make immediate payments towards their child support obligation. They may be asked to supply further information about their financial circumstances.

When the CIR is satisfied that a liable person is not able to make immediate payment, an instalment arrangement may be agreed to. Instalment arrangements that include current year child support obligations must include the minimum annual rate of child support payable for a current year, plus a reasonable amount toward reducing the child support debt. Consequently, any instalment arrangement must be for more than the minimum annual amount of child support payable.

An instalment arrangement will be structured so that the child support debt will be paid in the shortest possible time.

When the CIR agrees to an instalment arrangement, the terms will be confirmed in writing. That confirmation will set out both the liable person’s and the CIR’s obligations under the arrangement.

Liable persons who enter into an instalment arrangement must inform the CIR as soon as practicable if there is a change in their circumstances that may impact on an earlier decision to provide financial relief, or their ability to repay their child support debt.

The CIR will review instalment arrangements every 26 weeks (from the date of commencement) to confirm that the liable person has made the agreed payments. As long as the agreement has been complied with, incremental penalties relative to the debt paid during that period will be written-off.

Default on payment of an instalment may not undo the overall instalment arrangement. When the CIR is satisfied that a liable person is unable to pay their child support debt under an instalment arrangement, the terms of the instalment arrangement may be varied following discussion with the liable person. However, when an instalment arrangement is cancelled because a liable person does not comply with their repayment obligations, the CIR will consider whether other options may be available to collect the child support debt. Penalties will accrue on any unpaid amount.
Chapter 170

Companies

170.05 Definitions

A company is taxed in New Zealand under the principles of source and residence [see 760 INCOME FROM NEW ZEALAND AND FOREIGN SOURCES].

For the purposes of the ITA 2007, the term “company” is defined in s YA 1 and includes any body corporate or other entity which has a legal existence separate from that of its members, whether it is incorporated or created in New Zealand or elsewhere. It does not include a partnership, but it does include a listed limited partnership and a foreign corporate limited partnership. The definition also includes:

(a) A unit trust;
(b) A group investment fund that is not a designated group investment fund to the extent to which it results from investments made into it from a non-designated source on or after 23 June 1983;
(c) Airport operators;
(d) Statutory producer boards;
(e) Incorporated societies;
(f) Industrial and provident societies;
(g) Friendly societies; and
(h) Building societies.

“Widely-held company” means any company which has not less than 25 shareholders (with associated shareholders treated as one person) and is not a closely-held company. This concept is intended to refer to companies previously referred to as public companies [s YA 1].

“Close company” means a company for which there are five or fewer natural persons (with all natural persons who are associated being treated as one):

(a) The aggregate of whose voting interests in the company exceeds 50 per cent; or
(b) In any case where, at the time, a market value circumstance exists for the company, the aggregate of whose market value interests in the company exceeds 50 per cent,
but does not include a special corporate entity. The term “close company” replaces the previous terms “proprietary company” and “private company”.

“Closely-held company” means a company in which five or fewer persons (with associated shareholders treated as one person) own, in the aggregate, over 50 per cent of the direct voting interests or the direct market value interests where a market value circumstance exists [s YA 1]. Closely-held companies are considered to operate in a similar manner to partnerships and as a result, this definition is fundamental to the qualifying company regime, see 1160 QUALIFYING COMPANIES.

“Limited attribution company” means any building society, cooperative company, listed company, widely held company, or foreign company that is not a closely-held company [s YA 1]. This definition relates to the measurement of voting and market value interests in a company [see 170.15 to 170.25].

“Special corporate entity” means any public or local authority, any State-owned enterprise, any statutory producer board, any statutory body established by Act of Parliament which does not issue shares, any group investment fund (GIF), any Crown research institute, any life insurance fund, or any entity which has not issued shares and is mainly in the business of providing life insurance or other types of insurance to the public. This definition relates to the measurement of voting and market value interests in a company [see 170.15 to 170.25].

The provisions relating to a “qualifying company” are covered in 1160 QUALIFYING COMPANIES.

170.10 Control of company defined

The definition of “control” is important to the “associated persons” provisions in subpart YB [see 70 ASSOCIATED PERSONS AND RELATIVES]. The definition of control, in relation to a company, is as follows:

A company is under the control of the group of persons:

(a) Whose direct voting interests in the company exceed 50 per cent;

(b) In any case where a market value circumstance exists for the company, whose direct market value interests in the company exceed 50 per cent; or

(c) Who have control of the company by any other means [s YC 1].

A natural person is treated as holding rights held by a relative of that person [s YC 1(2)].

Where any nominee holds any rights at any time on behalf of or to the order of another person, the rights are deemed to be held at the time by the other person [s YB 21].

A general definition of the term “person” is not provided in the ITA 2007, other than for the purposes of the income equalisation regimes, which apply to the farming sector. The general definition of the term is now found in s 29 of the Interpretation Act 1999, which states:

“Person includes a corporation sole, a body corporate, and an unincorporated body:”

170.15 Voting and market value interests generally

The rules for measuring voting and market value interests apply for the purposes of:

(a) Loss carry-forward and grouping [see 940 LOSSES]

(b) The qualifying companies regime [see 1160 QUALIFYING COMPANIES]

(c) Carry-forward of credit under the imputation regime [see 670 IMPUTATION]

(d) Liability of directors and shareholders for tax of a company with insufficient assets to meet its tax liabilities under s HD 15 [see 40 AGENCY]

(e) The allowable deduction for interest under s DB 8 [see 830.40], and

(f) The consolidated companies regime [see 190 COMPANIES — CONSOLIDATION].

The voting and market value interests tests also prevent the trading of losses (eg by preventing a company from belonging to more than one group).
170.20 Voting interests [ss YA 1, YC 2, YC 3, YC 4, YC 18, YC 18B]

A voting interest is the percentage that a person holds of the total rights in a company attaching to shares or options to vote or participate in shareholder decision-making rights. Shareholder decision-making rights cover the issues of:

(a) Dividends and distributions by the company;
(b) The constitution of the company;
(c) Any variation of share capital of the company; and
(d) The appointment or election of directors.

Where percentages for these matters differ, the voting interest is an average of the differing percentages.

Example:

Ellen and Bill hold all the shares in Zed Ltd which has two classes of shares. Class A shares carry the right to vote on matters other than the payment of dividends and appointment of directors. Class B shares carry unrestricted voting rights. Ellen holds all 1,000 of the Class A shares. Bill holds all 1,000 of the Class B shares. In calculating the voting rights for Ellen, the average of each of the differing percentages is:

- Dividends and distributions: 0%
- Constitution of the company: 50%
- Variation of share capital: 50%
- Appointment or election of directors: 0%

Ellen’s average is 25 per cent. The same calculations for Bill produce an average of 75 per cent.

If a company holds shares in another company, the corporate chain is “looked through” to the ultimate shareholders. This involves applying the tracing test in s YC 4 to determine indirect voting interests. An ultimate shareholder’s indirect voting interest in a company held through interposed companies is their proportionate interest in that company, after taking into account any shareholding interests through the corporate chain.

Example:

John owns 40 per cent of the direct voting interests in Holdco Ltd. Holdco owns 60 per cent of the direct voting interests in SubCo1 Ltd. SubCo1 Ltd owns 100 per cent of the direct voting interests in SubCo2 Ltd. John’s indirect voting interests in SubCo2 are determined by multiplying his direct voting interest in Holdco Ltd against that company’s direct voting interest in SubCo1 Ltd and also against SubCo1 Ltd’s direct voting interest in SubCo2 Ltd. This calculation is 40% × 60% × 100% = 24%. This means John has a 24 per cent indirect voting interest in SubCo2 Ltd.

1) Corporate restructuring

The aim of the continuity rules is to ensure that a significant percentage of the economic ownership of a company remains in the hands of the same shareholders in order for the tax benefits of losses and imputation credits to remain available. However, unintended circumstances can arise where the standard rules are breached even where the economic ownership of a company has not changed. Special rules have been enacted to preserve continuity in certain circumstances.

Under s YC 18, which applies which apply when both companies involved in the takeover or merger are limited attribution companies [see 170.05], continuity will not be lost if:

(a) Immediately before the change in ownership, the initial parent is treated under the continuity rules as holding all of the ownership interests in the subsidiary;
(b) Immediately after the change in ownership, the new parent is treated under the continuity rules as holding all of the ownership interests in the subsidiary; and
(c) Before and after the change in ownership, each shareholder in the initial parent owns shares in the new parent as a result of the takeover in the same proportion to each other (ignoring any other interest that the shareholder may have in the new parent).
Where these tests are met, for the purposes of the continuity rules for loss carry-forward (49 per cent) and imputation (66 per cent), if the initial owners hold a sufficient interest in the new parent immediately after the change in ownership, the new parent is treated as having held those interests for the period for which they were treated as being held by the initial parent.

Under s YC 18B, which applies where the initial parent company in a group of companies is replaced by a new parent company but there is no change in the economic ownership of the group, continuity will not be lost where all of the following conditions are met:

(a) The initial parent is a limited attribution company [see 170.05] that is treated under ss YC 11(3) and YC 11(4) [see 170.05 para (g)] as holding ownership interests in another company prior to commencement of the restructuring;

(b) As a result of the restructuring, a new company is the parent and that new parent company is a limited attribution company;

(c) The percentage ownership that each shareholder receives in the new parent is the same as the percentage that they held in the old parent;

(d) No person who held shares in the initial parent receives a dividend, gift or other direct benefit as a result of the arrangement.

Note that a nominal amount of shares issued to facilitate the restructuring or in order to comply with securities law requirements are ignored in calculating these percentages. Also ignored in calculating the percentages are certain “excluded preference shares” that are disregarded under s 703-37 of the Australian Income Tax Assessment Act.

Where all of the above conditions are met, the new parent “steps into the shoes” of the old parent.

**170.25 When market value interest must also be calculated** [s YC 3]

A number of specified circumstances, called market value circumstances, require a market value test to be applied in addition to the voting interest test. This test ensures that shareholders must take into account any economic interests that differ from their voting interest in determining their total ownership interests in a company. Market value circumstances include:

(a) The issue of floating rate debentures and debentures issued in substitution for shares which do not have restricted rights to vote or participate in decision-making;

(b) The issue of a share where the dividends are guaranteed or secured by a third party with the knowledge or reasonably expected knowledge of the directors;

(c) The issue of put or call options (not being excluded options) to acquire shares in the company; and

(d) The entering into an arrangement to defeat the continuity provisions.

A market value circumstance also applies on any occasion where a direct market value circumstance is deemed to exist for any other shareholder company where the shareholder company is associated with the company and where any market value interest held by the shareholder company in the company is deemed to be held by any other person. A market value circumstance will not apply for a company where no share or option over a share in the company has a value higher than nil. In this situation, shareholders’ interests in a company will be measured solely by reference to voting interests. It is expected, given that a market value circumstance is narrowly defined, that the application of the market value test will be the exception rather than the rule. In the vast majority of cases, it should only be necessary to apply the voting interest.

The market value of an interest for shares or options listed on a recognised exchange is generally determined by reference to quotations on that exchange. For unlisted shares or options, it is the market price that a willing third-party purchaser would pay in an arm’s-length acquisition using a method that conforms with commercially acceptable practice. In appropriate cases it may have regard to the present value of the company’s anticipated income and cash flows and/or realisable value of assets. It must result in a value that is fair and reasonable taking into account the tenor of the rules.
**170.30 Instruments not counted in determining interests** [ss YA 1, YC 6]

Certain instruments are not counted when determining the continuity of voting interests and market value interests. These are:

(a) Excluded fixed rate securities, which mean any fixed rate shares or debentures with restrictive voting rights that only arise in protective situations. The voting rights are essentially passive, may only be used defensively to protect a shareholder’s interest in the company. The rights arise only in circumstances where the position of the holder may be altered to the holder’s detriment. They are granted to the holder for the purpose of assisting the holder to prevent that alteration. At the time of issue of the share or debenture the protective voting rights are not expected to arise.

(b) Excluded options are an option to acquire or dispose of a share where any of the following applies:

(i) The directors did not have actual or constructive knowledge that the option had been granted;

(ii) Neither the grantor (not being the company) nor any person associated with the grantor holds at the time the option is granted, any share over which the option is granted;

(iii) The option is granted on an arm’s-length basis (subject to an anti-avoidance provision) and the option does not carry any voting rights (other than protective voting rights);

(iv) The option exercise price is not materially different from the market value of the share at the date of exercise of the option and the option does not carry any voting rights (other than protective voting rights);

(v) The share is a fixed rate security subject to s YC 20 for the purposes of the credit account continuity provisions; or

(vi) The option is over a share issued before 30 July 1991.

A number of rules simplify calculations required under continuity provisions. The provisions specify when changes in shareholding and voting and market value interests are not required to be taken into account in determining the shareholder percentage requirements for loss carry-forward and grouping purposes. This limits the situations when tracing through shareholdings held through interposed companies to the natural person shareholders is required. The rules also apply to continuity provisions under the imputation regime.

**170.35 Modifications to measurements of interests for the continuity provisions**

Special rules exist in certain circumstances to modify the measurement of interests for the shareholder continuity provisions. These include:

(a) *The date of acquisition where there has been a transfer through a relationship property agreement or death.* Shares and options acquired from a spouse [see 960.10] or former spouse under a relationship property agreement or under a will or intestacy do not have an impact on the continuity calculations. They are deemed to be held from the original date of acquisition by the transferor or the deceased person [ss YC 8, FB 10].

(b) *The disposal of shares or options by a trustee company.* Where shares or options in a company (the first company) are held by a corporate trustee (other than the Public Trustee, a subsidiary of the Public Trustee or a statutory trustee company) and any shares or options in the corporate trustee are disposed of, issued, or granted, then the corporate trustee is deemed to have disposed of the shares or options in the first company at that time to an unrelated third party and to have reacquired those shares or options immediately afterwards. This does not apply where it can be established that the disposal of the shares or options did not change the beneficial ownership of the shares or options or it otherwise can be shown not to have a purpose or effect of defeating the intent and application of the continuity provisions [s YC 9].

(c) *Changes in beneficiaries in a trust.* Where there is a change in the beneficiaries of a trust under an arrangement which has a purpose or effect of defeating the intent and avoiding the application of the
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continuity provisions, there is a deemed disposition by the trustee of the share or option to an unrelated third party and an immediate reacquisition. This could affect continuity calculations [s GB 5].

(d) Treatment of trustees. Shares or options held by trustees of a trust are deemed to be held by the same single person at all times notwithstanding any change in the trustees. Changes in trustees do not affect continuity provisions unless the establishment or termination of the trust or a change in trustees has a purpose or effect of defeating the intent and application of the continuity provisions [s YC 9].

(e) The unit holders of a “public unit trust” (formerly a “qualifying unit trust”), in their collective capacity. These persons are treated as holding all shares in the public unit trust as if they were always the same notional single person (other than a company) whose existence is co-extensive with that of the public unit trust and who only holds shares in the public unit trust. If a qualifying unit trust exists on the first day of the 2001-2002 income year and chooses to use this provision, on the first day of that year, the balances of the public unit trust’s imputation credit account and any losses carried forward are treated as having been accumulated by the same notional single person, and that person is treated as always having existed in respect of the balance [s YC 12].

(f) Direct interests of less than 10 per cent. Where any person has a direct voting interest or market value interest of less than 10 per cent in a company and the person is not a company associated with the company, the interest of that person is pooled with all other interests of other persons with interests of less than 10 per cent and all the interests are deemed to be held by a notional single person. As a result transfers of shares between shareholders holding less than 10 per cent shareholdings can be disregarded [s YC 10].

Example 1:
Six shareholders (who are not corporate shareholders) each hold nine per cent interests in Loss Co Ltd. These interests are all deemed to be held by one nominee shareholder having a 54 per cent interest. The pooling of all less than 10 per cent direct interests takes place before the application of the corporate look-through rules. Therefore, it is not necessary to look through companies which hold less than a 10 per cent direct interest in another company. As a result transfers of shares between shareholders holding less than 10 per cent shareholdings can be disregarded.

Example 2:
In Example 1 there would be no change to the result if each of the shareholders was a corporate shareholder, provided that they were not associated companies.

Example 3:
If in Example 1, the six shareholders were corporate shareholders associated with each other and all shares in each of the six companies were 100 per cent owned by Bruce, each of the interests of those six companies are aggregated and attributed to Bruce. Consequently, when Bruce sells all of his shares in each of the six companies to Ross (a transfer of a 54 per cent interest), there is a breach of the 49 per cent continuity requirements necessary for Loss Co Ltd to carry-forward losses that are to be offset in a subsequent year. When the 10 per cent threshold is reached, the total interests of the person must be taken into account individually.

Example 4:
A shareholder with a six per cent interest in a company acquires additional shares to get a 14 per cent interest and consequently falls out of the 10 per cent pool. The increase in the shareholder’s interest is treated as a 15 per cent change in ownership in the company [see item (h) below].

(g) Limited attribution companies and minor shareholders [s YC 11]. Where a shareholder company is a limited attribution company and has voting interests or market value interests (as the case may be) of less than 50 per cent, or a shareholder (who is not associated with another shareholder) has a less than 10 per cent direct interest and would be deemed to have an interest of less than 10 per cent, the interests held by these shareholders need not be traced through for the continuity provisions. Accordingly, it is not necessary to trace through direct or indirect voting or market value interests of a listed company or a widely-held company to determine the ultimate individual shareholders where
the interests total less than 50 per cent. Such interests are not counted in calculating shareholder continuity requirements.

**Example 1:**
Sub Ltd is a listed company. The shareholders of Sub Ltd are Parent Ltd with a 45 per cent interest and 55 individual shareholders with one per cent interest each. Sub Ltd has a 100 per cent owned subsidiary (Subone Ltd) which holds 40 per cent of Subtwo Ltd. As Sub Ltd’s indirect interest in Subtwo Ltd is less than 50 per cent, ie 40 per cent (100% × 40%) no changes in shareholding of Sub Ltd affect the calculation of the continuity requirement in Subtwo Ltd in order to carry-forward losses in Subtwo Ltd.

The corporate look-through rules do not apply when a limited attribution company holds directly or indirectly a less than 50 per cent voting or market value interest in another company.

**Example 2:**
LAC Ltd increases its interests in Sub Ltd from 49 per cent to 51 per cent. This increase can be considered as a two per cent change instead of a 15 per cent change by both Subsidiary Ltd and Parent Ltd.

(h) It is intended to allow those interests that are less than 10 per cent to be counted separately if that assists in satisfying the shareholder continuity requirements [s YC 14].

**Example:**
A shareholder in a loss company with an eight per cent interest acquires additional shares to get a 12 per cent interest. Without this application it would be treated as a 12 per cent change in shareholding. It enables the shareholder’s interest to be counted separately from the beginning of the continuity period and the increase can be counted as four per cent and not 12 per cent.

(i) When continuity provisions are deemed not to be satisfied. An anti-avoidance provision exists so that the continuity provisions are deemed not to be satisfied when the directors of a company know or could reasonably be expected to know that the requirements of any continuity provision would not have been satisfied. It is not applied if a breach in continuity is due solely to ordinary trading on a recognised exchange between persons with less than 10 per cent interests in the company [s YC 15].

(j) The requirements of a continuity provision are deemed to be satisfied where the sole reason for a breach in continuity is due to one or a combination of:
   (i) A change in the market value of the tangible and intangible assets of the company; or
   (ii) A change in the market value of any one or more shares in the company which is not attributable to any change in the terms of those shares [s YC 16].

(k) There are special disclosure requirements for public unit trusts [see 1450.20].

170.40 **Retrospective adjustments to shareholder-employee salaries**

Standard practice statement SPS 05/05 sets out the CIR’s criteria for considering whether or not to recognise retrospective reductions to shareholder-employee salaries. The policy (which takes into account the decision in *TRA Case U27* (1999) 19 NZTC 9,261), takes effect from the 2005-2006 income year.

For the CIR to amend assessments in accordance with a request, the following criteria must be met:

(a) A genuine error has been made in the accounts of the company resulting in a legitimate deduction not being claimed or a receipt being miscategorised;

(b) As a result of correcting the error, the company decides to reduce the amount of salary previously allocated to a shareholder-employee;

(c) The company has passed a resolution reflecting the reduction in light of the relationship between the company and the employee; and

(d) A request for correction, and a copy of the resolution, have been filed with the CIR.

It is expected that any request will be made in a “timely fashion”, a term the meaning of which depends on the circumstances of the particular case [see TIB vol 17:4 (May 2005) at 18-21].
170.45  **Excessive remuneration to shareholder, director, or relative of close companies**  [s GB 25]

Where any sum paid or credited by a close company as remuneration for services rendered by a shareholder or director of the company, or a relative of such shareholder or director, exceeds such an amount as in the opinion of the CIR is reasonable, the amount of the excess is not deductible in the assessment of the company and is deemed to be a dividend paid by the company to that person  [s GB 25].

This does not apply where the CIR is satisfied that the person to whom the sum is paid or credited is

(a) An adult employed substantially full time in the business of the company;

(b) Participates in the management or administration of it; and

(c) The determination of the amount of the remuneration was not influenced by the fact that the recipient is a relative of a shareholder or director, and who is resident in New Zealand.

The mode of applying these provisions to approve a fair and reasonable remuneration of $28,000 to a wife shareholder/director/employee is set down in **TRA Case J99** (1987) 9 NZTC 1,560.

Where any claim is made for remuneration paid to a relative, the following information should be available, if necessary, to support the claim:

(a) Business qualifications possessed by that person;

(b) The nature of the services rendered;

(c) The approximate amount of time spent by the relative in the company’s business.

In **TRA Case J53** (1987) 9 NZTC 1,297, husband and wife shareholder directors of a close company were held entitled to reasonable directors fees of $1,500 each. The facts of the case were taken into consideration but the duties could be considered relatively minimal.

170.50  **Apportionment of expenditure of holding companies**

The CIR considers that expenses incurred by a company which acts as a holding company within a group of companies should be treated as follows:

(a) Where the holding company’s only income is dividends that are exempt income, the expenses are incurred in producing exempt income and no deduction is permitted for tax purposes  [see 230.20].

(b) Where the holding company has other income (eg investment income or fees from management or administrative services provided for a subsidiary or other companies in the group) the holding company is entitled to charge whatever expenses could be justified on an arm’s-length basis. It makes no difference whether the expenses are paid for, or charged by way of journal entry. Any such amount for those services is fully deductible to the subsidiary company and assessable to the parent. The expenses must then be allocated to exempt income and taxable income on the following bases:

(i) Expenses which directly relate to a particular type or class of income must be charged against that income.

(ii) Expenditure which cannot be directly related must be apportioned. Where the holding company is an investment company holding such assets as shares in a subsidiary, property, mortgages, or bonds, etc, the expenditure may be apportioned on the basis of assets employed in deriving each type of income.

(iii) Where there is also income from other activities (eg providing management services to the subsidiary or to other companies in the group), the expenditure may be apportioned on the basis of the time spent in the management or operational function relative to each activity.

(c) However, a holding company within a consolidated group is allowed a deduction for some administrative expenses even if the company derives no gross income  [see 190.41].

In **Marshall Richards Machine Co Ltd v Jewitt** (1956) 36 TC 511 (Ch), a holding company’s contribution to a subsidiary’s operating expenses was held not to be deductible, the payments being of the nature of capital financing advance. However, in **Robinson v Scott Bader Co Ltd** (1981) 2 All ER 1116 (EWCA Civ), salary
payments made to a holding company employee whilst engaged in rescuing a subsidiary were held to be deductible. The real purpose of payment was the improvement of the holding company’s operations.

170.55 New companies only assessable on income derived since incorporation

Where a newly incorporated company takes over a business, the company includes in its return of income only the amount of assessable income derived since incorporation. Any assessable income arising in carrying on that business prior to incorporation is derived either by the vendor or the trustee for the company to be incorporated.

Debts taken over by a company represent a capital asset. Consequently any amounts subsequently written-off as bad are a loss of capital, and any recoveries of those debts, or of debts written-off by the vendor, are not assessable.

However, if a company is formed for the purpose of acquiring by purchase or otherwise book debts or hire purchase agreements, the realisation of such debtors or agreements constitutes a business carried on by the taxpayer: *Batty v Parker* (1941) 23 TC 739. Consequently, realisations in excess of the purchase price are liable to taxation while losses are deductible. No preliminary expenses, eg brokerage, legal expenses incurred in the formation of the company etc, are allowable as a deduction.

In the case of a business acquired by a company, the stock on hand in the first return should be brought in at the price appearing in the agreement or contract of sale. In the case of fixed assets taken over, the basis on which depreciation is allowed in the first year is the actual cost price to the company (except where the vendor is not at arm’s length, and the cost to the company exceeds the original cost to the vendor).

170.60 Companies in liquidation

The term “liquidation”, for a company, includes:

(a) Removal of the company from the register of companies under the Companies Act 1993; and
(b) Termination of the company’s existence under any other procedure of New Zealand or foreign law [s YA 1].

“Liquidate” has a corresponding meaning.

A liquidator is liable to furnish a return of assessable income calculated up to the date of liquidation. The income tax on taxable income derived may be assessed and demanded immediately under s 44 of the TAA. Any assessable income arising subsequent to the date of liquidation requires a subsequent return of income derived during the period from the date of liquidation to the company’s annual balance date. Subsequent returns must be rendered annually to the date of the company’s annual balance. In arriving at the net income, only expenses actually incurred in the production of the income of the year are allowable.

In *Federal Commissioner of Taxation v Marr (EA) & Sons (Sales) Ltd* (1984) 15 ATR 879, 84 ATC 4,580 (FCA), the company had leased equipment from finance companies which it made available to wholly owned subsidiaries on the basis that they paid the rentals due. While the company was in liquidation it derived no income directly from the leases but payments of rentals were assumed by the liquidators and were held deductible to the company. Costs of realisation of the assets are generally not deductible. In addition to annual accounts from the liquidator, the CIR insists on final accounts being furnished, showing the final realisation.

A company retains its corporate entity despite the process of liquidation. The fact of liquidation does not result in the company or the liquidator being a separate taxpayer to that prior to the date of liquidation. If, after the liquidation commences, business is carried on, it is carried on not by the directors but by the liquidator, and whatever the liquidator does in carrying it on is done in the name of and on behalf of the company. It follows, therefore, that the liquidator may claim the benefit of past losses incurred by the company which are ordinarily deductible against future profits.

Special provisions determine whether amounts distributed on a liquidation are dividends [see 270 DIVIDENDS].
170.65 Corporate migration [ss FL 1, FL 2, CD 14, CD 26, CD 43, OC 5, OC 31, RA 18, OB 60; TAA, ss 49, 51]

A company that migrates, and thereby becomes non-resident, on or after 21 March 2005 is treated for tax purposes as if it had realised all of its assets at market value, been liquidated, and distributed the proceeds to its shareholders [s FL 1].

A company has migrated if it is no longer resident in New Zealand under s YD 2 [see 1250.60]. The migration rules do not apply where a company is dual resident and treated under a double tax agreement as tax-resident in another country.

The deemed distribution is taxable in the hands of the company’s New Zealand resident shareholders [ss FL 2, CD 14]. The company is able to attach imputation credits to the deemed distribution and is required to withhold tax in the normal way. Imputation credits arising from tax payable as a result of the migration are able to be used in addition to any imputation credits already in existence [s OB 60]. Resident shareholders are subject to resident withholding tax (RWT). The company must pay the RWT within three months of emigration [s RA 18; TAA, s 51]. Non-resident shareholders are subject to non-resident withholding tax. The company must pay the RWT within three months of emigration [s RA 18; TAA, s 49]. For resident shareholders and non-resident shareholders who are not related companies, there is an exclusion for available subscribed capital and realised capital reserves [s CD 26]. There is no exclusion for realised capital reserves on amounts distributed to non-resident related corporate shareholders.

The amount of the deemed distribution is added to the company’s available subscribed capital to remove the potential for double taxation in the event that the company distributes a dividend to its shareholders after it has migrated [s CD 43(16)].

Property that was subject to the deemed disposal is deemed to have been reacquired by the company at the same market value as was used for the deemed disposal. Where the property remains subject to tax in New Zealand, a new cost base is thereby established [s FL 1(2)(b)].

Companies that migrate cease to be an FDP company and also cease to be a conduit tax relief company. A conduit tax relief company is also required to make an additional FDP payment of the amount of any credit balance in its conduit tax relief account [ss OC 5, OC 31].

TaxNote Both the FDP rules and conduit tax relief rules have been repealed and foreign dividends derived by a New Zealand resident company are exempt from tax, both with effect from the beginning of the first income year commencing on or after 1 July 2009 [see 850 INTERNATIONAL TAX REGIME, 215 CONDUIT TAX RELIEF].

170.70 Own-your-own flat companies

It is usual for “own-your-own” flat companies to levy their shareholders to cover administration and management costs as well as repairs and maintenance, depreciation, etc. For practical purposes these companies are similar to trust companies. Generally, any portion of the levies paid by shareholders and not expended during the year is simply held in trust and does not constitute income of the company.

If a shareholder uses the flat in the production of income, depreciation at the appropriate rate (where depreciation is not already included in the levy) is allowed as a deduction. If the actual cost is not known the following formula is used to arrive at the cost of the building:

\[
\text{Cost} = \frac{\text{Government Valuation of Improvements}}{\text{Total Government Valuation}} \times \frac{\text{Total Cost}}{1}
\]

The shareholder’s proportion of the cost will then be calculated in the proportion that the shareholding bears to the total shareholding in the own-your-own flat company.

“Flat-owning company” is defined in s CD 22(2) and means a company:

(a) Whose constitution provides that each registered shareholder is entitled to the use of a residential property in New Zealand owned by the company; and
(b) Whose only significant assets are residential properties available for use by specific shareholders and funds reserved for meeting the company’s costs.
Chapter 180
Companies — Amalgamation

180.10 Purpose [ss FO 1, FO 4(3)]
Companies may amalgamate into an existing or a new company under s 219 of the Companies Act 1993. Taxation provisions exist:
(a) To specify certain taxation consequences of the amalgamation of companies;
(b) For resident’s restricted amalgamations (formerly “qualifying amalgamations”), to permit certain property to be transferred to an amalgamated company on a concessional taxation basis and an amalgamated company to succeed to tax losses and imputation credit account and other credits of amalgamating companies, subject to tests of continuity and commonality of ownership being met; and
Companies — Amalgamation

180.15 Definitions [s YA 1]

“Amalgamated company” means the one company that results from, and continues after, an amalgamation. It may be one of the amalgamating companies or a new company. For an amalgamation of building societies, it is the building society that is described as “society B” in the definition of “amalgamation” (see below).

“Amalgamating company” means any company which amalgamates with one or more other companies under an amalgamation. For an amalgamation of building societies, it is the building society that is described as either “society A” or “society B” in the definition of “amalgamation” (see below).

“Amalgamation” means any amalgamation under:

(a) Part 13 or Part 15 of the Companies Act 1993; or
(b) The law of any country or territory other than New Zealand which is to the same or similar effect, whereby two or more companies amalgamate and continue as one company.

For an amalgamation of building societies, “amalgamation” means a transfer by a building society (“society A”) all of its engagements to another building society (“society B”) under s 33 of the Building Societies Act 1965, if all of the following conditions are met:

(a) A notice of transfer is registered under s 34(3) of the Building Societies Act 1965;
(b) Society A’s funds, property, and assets are transferred to society B, except to the extent necessary to settle its affairs before being removed from the register of building societies;
(c) Society A does not carry on business after the notice is registered, except to the extent necessary to settle its affairs before being removed from the register of building societies; and
(d) Society A’s liabilities are either satisfied or assumed by society B; Society A is, or will be, removed from the register of building societies as soon as practicable after the notice is registered.

“Attributed CFC income” is defined in s CQ 2 [see 850.50].

“Attributed CFC loss” is defined in s DN 2 [see 850.50].

“CFC tax credit” means a tax credit available for crediting under s LK 1(1) [see 850.95].

“Depreciating property” (in relation to a taxpayer) means property for which the taxpayer is allowed a deduction for depreciation or amortisation expenditure in calculating net income [see 250 DEPRECIATION].

“Financial arrangement” has the meaning assigned to that term by s EW 3 [see 470.20].

“Resident’s restricted amalgamation” (formerly “Qualifying amalgamation”) means any amalgamation where:

(a) Each of the amalgamating companies and the amalgamated company is, at the time of the amalgamation, resident in New Zealand and is not:
   (i) A company which is not treated under a double tax agreement as being resident in another country for the purpose of the agreement; or
   (ii) A company which derives only exempt income other than income which is exempt under s CW 9 (foreign dividends) and s CW 11 (dividends received by a conduit relief holding company), including any local authority that is not a council-controlled organisation; and
(b) If the amalgamated company is, immediately after the amalgamation, a qualifying company (as defined in s HA 2), each of the amalgamating companies is a qualifying company; and
(c) If the amalgamated company is, immediately after the amalgamation, a loss attributing qualifying company (as defined in s HA 3), each of the amalgamating companies is a loss attributing qualifying company (LAQC); and
Companies — Amalgamation

(d) The amalgamating companies and the amalgamated company have not elected that the amalgamation will not be a resident’s restricted amalgamation.

“Revenue account property” is property that falls within any one or more of the following categories:

(a) Property that is trading stock of the person; or

(b) Property that, if disposed of for valuable consideration, would produce income for the person other than income under ss EE 48 (depreciation recoveries), FA 5 (Assets acquired or disposed of after deductions of payments under lease), or FA 9 (Lessee acquiring asset when lease ends); or

(c) Property that is an emissions unit of the person.

“Trading stock” has the meaning assigned to that term by s YA 1 [see 1400 TRADING STOCK].

180.20 Notice of amalgamation to CIR [TAA, s 75]

Where an amalgamation occurs, the amalgamated company must, within 63 working days of the date on which:

(a) Documents evidencing the amalgamation are delivered to the Registrar of Companies for registration under Part 13 or Part 15 of the Companies Act 1993;

(b) For any amalgamation under s 24A of the Co-operative Dairy Companies Act 1949, the extraordinary resolution referred to in s 24A(3)(g) is passed; or

(c) For any amalgamation occurring under foreign law, the equivalent procedure occurs under foreign law,

give notice in writing to the CIR, in an approved form, detailing:

(a) The name and tax file number (if any) of each amalgamating company and the amalgamated company;

(b) The date upon which the amalgamation has effect;

(c) In any case where the amalgamated company has a non-standard balance date, the non-standard balance date; and

(d) Such other information as may be required.

180.25 Available subscribed capital when amalgamating company shares cancelled [s CD 43(24), (25)]

Where:

(a) An amalgamated company is one of the amalgamating companies; and

(b) Any shares in that amalgamating company held by another amalgamating company are cancelled on an amalgamation,

in calculating the available subscribed capital remaining on issue after the amalgamation, the “returns” amount [see 270.40] that is included in the calculation of available subscribed capital is increased by the amount calculated in accordance with the following formula:

\[
\text{cancelled shares} \times \text{asc per share}
\]

Where:

“asc per share” is the available subscribed capital per cancelled share is calculated under the slice rule immediately before the amalgamation; and

“cancelled shares” is the number of cancelled shares.

180.30 No taxable dividends when amalgamating company ceases to exist [ss CD 35, CD 44(8)]

Where an amalgamating company ceases to exist on a resident’s restricted amalgamation:

(a) The amalgamated company is deemed not to derive a dividend from the amalgamating company by virtue of:
(i) Acquisition by the amalgamated company of any property of the amalgamating company; or
(ii) Relief of the amalgamated company from any obligation owed to the amalgamating company; and

(b) If the amalgamating company has capital gain amounts available for distribution at the time of the amalgamation and which are not distributed to its shareholders (other than the amalgamated company) in the course of the amalgamation, the amalgamated company is treated as deriving a capital gain amount equal to the capital gain amount of the amalgamating company.

180.35 Amalgamated company shares cancelled [s FO 6]
Where shares in any amalgamating company are:
(a) Held by another amalgamating company, and
(b) Cancelled on the amalgamation,
the shares are deemed to have been disposed of by the shareholder amalgamating company immediately before the amalgamation for a consideration equal to the cost of the shares to the shareholder amalgamating company.

180.40 Obligations when amalgamating company ceases to exist [ss FO 4, FO 5; TAA s 76]
Where any amalgamating company ceases to exist on an amalgamation, the amalgamated company must, in accordance with s 225 of the Companies Act 1993, comply with all obligations of and meet all liabilities of, and be entitled to all rights, powers and privileges of, the amalgamating company under the Inland Revenue Acts for the income year in which the amalgamation occurs and all preceding income years.
The assumption by an amalgamated company of the liabilities and obligations of an amalgamating company does not result in the amalgamating company deriving income from the remission of debt under ss CG 2 or DB 47.

180.45 Bad debts or expenditure when amalgamating company ceases to exist [s FO 8]
Where:
(a) Any amalgamating company ceases to exist on a resident’s restricted amalgamation; and
(b) The amalgamated company at any time:
   (i) Writes off as a bad debt any debt acquired from the amalgamating company at the time of the amalgamation; or
   (ii) Incurs any expenditure, loss, or depreciation by virtue of anything done or not done by the amalgamating company; and
(c) The amount of the bad debt, expenditure, loss, or depreciation would not otherwise be allowed as a deduction in calculating the net income of the amalgamated company; and
(d) The amount would have been allowed as a deduction in calculating the net income of the amalgamated company but for the amalgamation,
the amount is allowed as a deduction under s DV 15(2) in calculating the net income of the amalgamated company for the period.

180.50 Interest on money borrowed to acquire shares in amalgamating company that ceases to exist [s DB 8(3) (4), (5)]
A continuing deduction is allowed to a company for the interest payable on money that it borrowed to acquire shares in an amalgamating company when the amalgamating company ceases to exist following a resident’s restricted amalgamation of the two companies. The interest continues to be allowed as a deduction in
subsequent income years after the amalgamation has taken place. The two companies must be members of the same group of companies immediately before the amalgamation.

Example:
Action Ltd borrowed funds to purchase shares in Defeat Ltd. Action Ltd and Defeat Ltd join together in a resident’s restricted amalgamation and Defeat Ltd ceases to exist. Immediately before the amalgamation both Action Ltd and Defeat Ltd were members of the same group of companies. Interest payable on the funds borrowed both in the income year when the resident’s restricted amalgamation has taken place and in subsequent income years, continues to be an allowable deduction for Action Ltd.

180.55 Unexpired accrual expenditure of amalgamating company which ceases to exist and profits derived by amalgamated company

[ss FO 9, FO 7, CV 4]

Where any amalgamating company ceases to exist on an amalgamation during any income year:
(a) The unexpired portion of any amount of prepayment expenditure of the amalgamating company for the income year is deemed to be the unexpired portion of an amount of prepayment expenditure of the amalgamated company for the income year. It is also deemed not to be prepayment expenditure of the amalgamating company for the income year; and
(b) Any profit or gain derived by the amalgamated company at any time after the amalgamation which:
   (i) Is derived by virtue of anything done or not done by the amalgamating company; and
   (ii) Would have been income of the amalgamating company but for the amalgamation,
is income of the amalgamated company.

Paragraph (a) requires the amalgamating company to transfer unexpired prepayment expenditure to the amalgamated company on amalgamation. As a result, the amalgamating company must include this amount of unexpired accrual expenditure in its calculation of taxable income in preparing its final tax return to the date of amalgamation. The amalgamated company will then be allowed a deduction for the unexpired portion of the accrual expenditure (as at the date of amalgamation) in the year of amalgamation. Paragraph (b) provides that the profit or gain will be assessable to the amalgamated company if it would have been assessable to the amalgamating company.

180.60 Property or obligations under a financial arrangement acquired by an amalgamated company in a non-resident’s restricted amalgamation

[ss FO 11, FO 15]

Where any amalgamated company, on an amalgamation other than a resident’s restricted amalgamation, acquires any property of an amalgamating company, or succeeds to any obligations of an amalgamating company for a financial arrangement of which the amalgamating company is a party:
(a) The amalgamating company is treated as having disposed of the property or relieved itself of the obligations immediately before the amalgamation; and
(b) The amalgamated company is treated as having acquired the property or assumed the obligations immediately after the amalgamation,

for a consideration equal to the market value of the property, or market price for assuming the obligations, at the time.

However, the amalgamating company under a non-resident’s restricted amalgamation is treated as being in existence at the time of amalgamation for the purposes of s EE 41. This means that, where the amalgamating company which owns the asset in question meets the associated person test with the amalgamated company, the amalgamated company will not be able to claim any greater amount of depreciation than the amalgamating company could have claimed.
Example:

Company A, which has a share capital of $100 currently owned by Anne, and Company B, which has share capital of $50 currently owned by Bob, are amalgamating into new Company C which will have a combined share capital of $150 owned as to $100 by Anne and $50 by Bob. All shares carry equal voting rights. As Company A and Company C are associated, assets transferred by Company A will be subject to the associated persons rule whereas assets owned by company B will not.

180.65 Property acquired by an amalgamated company in a resident’s restricted amalgamation [ss FO 10, FO 16, DV 15]

Where an amalgamated company, on a resident’s restricted amalgamation, acquires any property of an amalgamating company:

(a) The amalgamating company is treated as having disposed of the property, and the amalgamated company is treated as having acquired the property, immediately before the amalgamation [s FO 10(3)]; and

(b) The amalgamated company is deemed to have acquired the property on the date on which it was acquired by the amalgamating company; and

(c) The amalgamated company is deemed to have acquired the property from the amalgamating company for consideration equal to:

(i) The original purchase price of the property;

(ii) Any expenditure incurred in purchasing or improving the property; and

(iii) Any expenditure incurred in securing or improving the legal rights of the amalgamating company for the property;

(d) Where the property forms the whole of a pool of property that is depreciated by the amalgamating company, the adjusted tax value of the pool immediately before the amalgamation [s FO 16(2)].

(e) Where the property forms part only of any pool, the lesser of:

(i) The market value of the property acquired by the amalgamated company; and

(ii) The adjusted tax value of the whole of the pool immediately before the amalgamation [s FO 16(3)];

(f) Where an amalgamated company, on a resident’s restricted amalgamation, acquires depreciating property (other than pooled property) of the amalgamating company, the amalgamated company is deemed to have been allowed a deduction for the same amounts of depreciation or amortisation as has been allowed in calculating the net income of the amalgamating company [s FO 16(1), (4)].

The transfer of depreciating property to an amalgamated company on a resident’s restricted amalgamation does not give rise to any income or deductions as a result of depreciation recovered or additional depreciation. However, the amalgamating company is permitted a deduction for depreciation for the period from the first day of the income year to the day immediately preceding the day of amalgamation [ss DV 15, FO 10(7)].

180.70 Trading stock acquired by an amalgamated company in a resident’s restricted amalgamation [s FO 10(5)]

Where an amalgamated company, on a resident’s restricted amalgamation, acquires any property of an amalgamating company which is trading stock for both the amalgamating company and the amalgamated company, the amalgamating company is deemed to have disposed of the trading stock and the amalgamated company is deemed to have acquired the trading stock for a consideration equal to the value of the trading stock under subpart EB (the trading stock rules) at the time of the amalgamation.

180.75 Revenue account property and land acquired by an amalgamated company in a resident’s restricted amalgamation [ss FO 10(6), FO 17]

Where an amalgamated company, on a resident’s restricted amalgamation, acquires any revenue account property of the amalgamating company which is not revenue account property of the amalgamated company,
the amalgamating company is deemed to have disposed of the property and the amalgamated company is
debt to have acquired the property at the time of the amalgamation for a consideration equal to its market
value at that time.

This does not apply where the property is land that is (or may be) revenue account property of the
amalgamating company only by virtue of the 10 year rules applying to certain profits on land sale transactions.
However, if the amalgamated company disposes of the property within 10 years after the date of its acquisition
by the amalgamating company, any profit or gain from the disposition is income of the amalgamated
company.

Where an amalgamated company, on a resident’s restricted amalgamation, acquires any amalgamating
company’s land which is not revenue account property of the amalgamating company but is revenue account
property of the amalgamated company, the amalgamating company is deemed to have disposed of the land
and the amalgamated company will be deemed to have acquired the land at the time of the amalgamation for
a consideration equal to its market value at that time.

180.80 Land or business acquired by amalgamated company and
amalgamating company ceases to exist [s DV 14]

In calculating the net income of an amalgamated company for an income year, a deduction is allowed where
all of the following apply:

(a) An amalgamating company ceases to exist on a resident’s restricted amalgamation;
(b) As a result, the amalgamated company acquires any land or business of the amalgamating company;
(c) But for the amalgamation, the amalgamating company would have been entitled to a deduction for
expenditure on land improvements for farming, horticulture, forestry, or aquaculture for the land or
business; and
(d) After the amalgamation and for the remainder of the income year the land is held, or the business is
carried on, by the amalgamated company.

The amount of the deduction is the amount that the amalgamating company would have been allowed had
the amalgamation not occurred.

180.85 Financial arrangement acquired by amalgamated company in a
resident’s restricted amalgamation [ss FE 6, FE 7]

Where during an income year and on a resident’s restricted amalgamation (and in spite of the rules relating
to non-market dispositions in s GB 21), any amalgamated company acquires a financial arrangement of an
amalgamating company, special provisions apply provided that the following conditions are satisfied:

(a) The financial arrangement rules apply to the financial arrangement;
(b) The amalgamating company and the amalgamated company were members of the same wholly-
owned group of companies at all times in the income year before the amalgamation;
(c) The method of calculating the income or expenditure for the financial arrangement remains the same
notwithstanding the amalgamation;
(d) The amalgamating company is not entitled to carry forward to the income year and deduct or set off
any net loss of the company for any preceding income year (except where the whole of the net loss
may be set from the net income of the amalgamated company for the income year under s IE 2); and
(e) The amalgamated company makes an election when filing its tax return for the income year.

If the above conditions are satisfied:

(a) The amalgamating company is treated as if it had never held the financial arrangement before the
amalgamation, with the result that the base price adjustment calculation does not apply to the
amalgamating company for the disposition by the amalgamating company of the financial
arrangement; and
(b) The amalgamated company is treated as if it had:
(i) Acquired the financial arrangement at the same time and for the same acquisition price as the amalgamating company;
(ii) Incurred all other expenditure and derived all gains incurred or derived by the amalgamating company for the financial arrangement before the amalgamation; and
(iii) Included in its returns of income the same amounts of income and expenditure for the financial arrangement as were included by the amalgamating company,

for the income year in which the amalgamation takes place and each subsequent income year:

In any other case where the method of calculating income or expenditure for the financial arrangement remains the same notwithstanding the amalgamation, the:

(a) Amalgamating company is treated as having disposed of the financial arrangement; and
(b) Consideration for the disposition by the amalgamating company is deemed to be equal to an amount which will result in the base price adjustment for the amalgamating company being an amount (whether negative, positive, or a nil amount) that would represent the income and expenditure that the amalgamating company would have derived or incurred in the income year had the amalgamation not occurred [s FO 13].

In any other case, the consideration for which the disposition takes place is deemed to be equal to the market value of the financial arrangement at the date of amalgamation [s FO 14].

Where any amalgamated company succeeds during an income year, on a resident’s restricted amalgamation, to the obligations of an amalgamating company for a financial arrangement the circumstances apply in reverse to the amalgamated company acquiring the financial arrangement.

180.90 Treatment of financial arrangements when parties amalgamate
[ss FO 18, FO 19, FO 20]

Where the parties to a financial arrangement amalgamate, the treatment differs between situations where the borrower is solvent and situations where the borrower is insolvent.

(1) Borrower is solvent or is insolvent but is likely to be able to meet its obligations under the financial arrangement

Where, immediately before the amalgamation, the amalgamating company that is the borrower is solvent or is insolvent but likely to meet its obligations under the financial arrangement:

(a) The financial arrangement is, for the purposes of the base price adjustment, deemed to be discharged immediately before the amalgamation; and
(b) The amalgamating company is deemed to have paid to the other party in consideration for the discharge:
   (i) For a resident’s restricted amalgamation, the outstanding accrued balance; or
   (ii) In any other case, the market value of the financial arrangement as at the date of the amalgamation.

No remission occurs as a result of the discharge. However, the amalgamated company is deemed to have remitted an amount equal to the excess (if any) of the outstanding balance over the market value (see below).

(2) Borrower insolvent

The borrower is treated as being insolvent if it does not satisfy the solvency test in ss 4 of the Companies Act 1993.

Where, immediately before the amalgamation, the amalgamating company that is the borrower is insolvent and is unlikely to meet its obligations under the financial arrangement:

(a) The financial arrangement is, for the purposes of the base price adjustment, discharged immediately before the amalgamation; and
The amalgamating company is deemed to have paid to the other party in consideration for the discharge the market value of the financial arrangement as at the date of the amalgamation;

(c) The other party to the financial arrangement is deemed to have remitted the excess over market value of the borrower’s outstanding accrued balance [s FO 18(4)].

(3) Outstanding accrued balance

The amalgamating company’s accrued balance is calculated under s FO 19 as follows:

\[
\text{consideration} + \text{prior expenditure} + \text{expenditure accrued in year of amalgamation} - \text{income accrued in year of amalgamation} - \text{consideration paid before amalgamation}
\]

Where:

“Consideration” is the consideration paid to the amalgamating company under the financial arrangement.

“Prior expenditure” is expenditure incurred less income derived by the amalgamating company under a spreading method or a s EW 53 avoidance adjustment in all previous tax years since the financial arrangement was entered into.

“Expenditure accrued in year of amalgamation” is expenditure incurred by the amalgamating company under the financial arrangement for the part of the tax year up to the date of amalgamation using the appropriate spreading method.

“Income accrued in year of amalgamation” is income accrued by the amalgamating company under the financial arrangement for the part of the tax year up to the date of amalgamation using the appropriate spreading method.

“Consideration paid before amalgamation” is the consideration paid by the amalgamating company for the financial arrangement before the amalgamation.

The formula for the other party to the amalgamation is calculated under s FO 20 as follows:

\[
\text{consideration} + \text{prior income} + \text{income accrued in year of amalgamation} - \text{expenditure accrued in year of amalgamation} - \text{consideration paid before amalgamation}
\]

Where:

“Consideration” is the consideration paid by the party under the financial arrangement.

“Prior income” is income derived less expenditure incurred by the other party under a spreading method or a s EW 53 avoidance adjustment in all previous tax years since the financial arrangement was entered into.

“Income accrued in year of amalgamation” is the income accrued by the party from the beginning of the tax year in which the amalgamation occurs up to the date of amalgamation.

“Expenditure accrued in year of amalgamation” is expenditure accrued by the party under the financial arrangement for the part of the tax year up to the date of amalgamation using the appropriate spreading method.

“Consideration paid before amalgamation” is the consideration paid to the party under the financial arrangement before the amalgamation.

In most cases, the parties will both be using either one of the IFRS methods or the yield to maturity method to account for the financial arrangement. However, if the borrower and lender have used different methods, the lender’s deemed income will reflect a matching of the borrower’s total deductions, and not the accrued value of the financial arrangement to the lender.

180.95 Loss incurred by, or tax credits held in, an amalgamating company that ceases to exist [ss IE 1, IE 2, IE 3, IE 5, IQ 1, LK 12, LK 13, LK 14, LK 15]

An amalgamating company that ceases to exist on a resident’s restricted amalgamation may have and available net loss, an attributed CFC net loss, or a foreign investment fund (FIF) net loss. These losses may not have been set off against the net income of the amalgamating company or any other company in any period prior to the amalgamation. The amalgamating company may also have a controlled foreign company
(CFC) tax credit that has not been credited against the income tax payable by the company for any period, and there are no restrictions on the company offsetting the losses or utilising the tax credit.

In these circumstances, those losses are treated as if they were incurred by the amalgamated company and offset against its net income, and the tax credit may be treated as a tax credit of the amalgamated company.

Where a net loss, an attributed CFC net loss, a FIF net loss, or the tax credits apply to two or more amalgamating companies, those losses or tax credits must be deducted in the same order as incurred or arising, or in the order elected by the amalgamated company, or on a pro rata basis. Similar provisions exist allowing an amalgamated company to carry forward and/or offset pre-existing unutilised losses and tax credits to the period after the amalgamation occurs, subject to the amalgamated company satisfying the standard requirements for carry forward and offset.

180.100 Fringe benefit tax payments when amalgamating company ceases to exist [ss CX 37, RD 45, RD 46]

Where any amalgamating company ceases to exist on an amalgamation if the amalgamating company pays fringe benefit tax on a quarterly basis and the amalgamation occurs during a quarter, the *de minimis* exemption amount is proportionately adjusted.

180.105 Provisional tax payments when amalgamating company ceases to exist [s RC 33]

Where any amalgamating company ceases to exist on an amalgamation, the residual income tax of the amalgamated company in the income year preceding the income year in which the amalgamation takes place is deemed to be equal to the amount which would have been such residual income tax had the amalgamating company and the amalgamated company always been one company. This applies only for instalments of provisional tax payable after the amalgamation.

180.110 Imputation credit account balances when amalgamating company ceases to exist [ss OA 9, OA 10, OA 11, OA 14, OA 15, OA 16, OA 17, OB 24, OB 53]

Where any amalgamating company ceases to exist upon a resident’s restricted amalgamation (formerly “qualifying amalgamation”), and where, immediately before the amalgamation, a credit or debit exists in the amalgamating company’s imputation credit account, dividend withholding payment account, branch equivalent tax account, or policyholder credit account, that amount is treated with effect from the time of the amalgamation as a credit or debit in the equivalent account of the amalgamated company. If the amalgamated company does not have an equivalent account (except for a branch equivalent tax account) the credit or debit is recorded in its imputation credit account. The effect is as if, for all times prior to the amalgamation, the amalgamated company did not separately exist and was instead the amalgamating company with the same holders of shares and options over shares as the amalgamating company each holding the same number and class of shares and options over shares as they held in the amalgamating company.

Where any amalgamating company ceases to exist upon a resident’s restricted amalgamation, and any credit which would have arisen, but for the amalgamation, is to be recorded in the imputation credit account, dividend withholding payment account, or branch equivalent tax account of the amalgamating company on a date after the amalgamation, that credit or debit is instead recorded in the equivalent account of the amalgamated company.

These provisions apply, with any necessary modifications, for any tax paid by the amalgamating company as if it and the amalgamated company were a single company. Similar provisions exist for a consolidated group.
# Chapter 190
## Companies — Consolidation

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### 190.05 Consolidating tax affairs for company groups

The consolidation regime treats a group of companies owned by the same shareholders as one economic entity and enables tax-free intra-group asset transfers to take place. A consolidated group is effectively treated as a single company for tax purposes. An important aim of the regime is to simplify the administration of the tax affairs of a group of companies. One of the original objectives of consolidation was to reduce the disadvantage to wholly-owned groups caused by the removal of the inter-corporate dividend exemption. However, the inter-corporate dividend exemption for wholly-owned groups (whether or not they consolidate) has been retained [see TIB vol 4:5 (December 1992)].

Under the consolidation regime, wholly-owned groups of companies are able to:

(a) Transfer assets within the consolidated group, with deferred income tax consequences and no gift duty consequences;

(b) Claim deductions for administration and other costs of holding companies which may not be deductible to the company that incurred the expenditure;
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190.10 Companies able to consolidate [ss FM 35, FM 31]

Companies can only be members of the same consolidated group if they meet all the following conditions:

(a) They are all eligible companies;
(b) The companies are a wholly-owned group of companies;
(c) All the companies have the same balance date;
(d) If one of the companies is a qualifying company then all the companies are qualifying companies;
(e) If one of the companies is a mining company, all the companies are mining companies; and
(f) No shares in the companies have been subject to any arrangement whose purpose is to defeat the intent of the consolidation rules.

These criteria are now explained in more detail.

1 Eligible companies

Consolidation is restricted to “eligible companies” as defined in s FM 31(1). To be an “eligible company”, a company must meet all the following conditions:

(a) Resident in New Zealand;
(b) Not a foreign company;
(c) Not a company that derives only exempt income (other than dividends that are exempt under s CW 9 (foreign dividends), s CW 10 (wholly-owned group company dividends) and s CW 11 (conduit relief holding companies);
(d) Not a loss attributing qualifying company; and
(e) Unless the company is a “grandparented consolidated company”, it must either be incorporated in New Zealand or be carrying on business in New Zealand, and not be liable to income tax in another jurisdiction by reason of domicile, residence, or place of incorporation.

A loss attributing qualifying company may not consolidate because it can only have one class of share and, by definition, a group consisting of two companies has at least two classes of shares.

The requirement in para (e) buttresses the loss offset rules by preventing losses from being offset in two different jurisdictions [see 190.55]. The amended definition of eligible company does not apply to taxpayer companies that were members of a consolidated group under the previous law where:

(a) The company elected to be part of the consolidated group before 17 May 2006;
(b) The company is carrying on a business; and
(c) Less than 50 per cent of the company’s total allowable deductions for the previous income year were interest deductions or deductions under the financial arrangement rules.

Tax positions taken prior to the amendment are preserved by the definition of “grandparented consolidated company” [s FM 31(3)]. The effect of the definition is as follows:

(a) Where the taxpayer company was a member of the consolidated group at the time at which the position was taken, positions taken in the 1998 to 2005 income years are protected; and
(b) Existing dual-resident members of a consolidated group are protected for the 2006 and 2007 income years provided that they elected to join the consolidated group before 17 May 2006.
(2) Wholly-owned group
Consolidation is only available to New Zealand resident companies that are a wholly-owned group. Section IC 4 sets out the way in which 100 per cent common ownership is determined. At any one time, a group of people must own between them 100 per cent of the interests in every company in the group. In addition, they must own the interests in the same proportions for each company.

Example:
Group made up of a holding company and its subsidiaries:

```
        X
rail        Y
rail        Z
rail
Holding Co
rail
Sub Co 1
rail
Sub Co 2
rail
Sub Co 3
```

Example:
Group of commonly owned related companies:

```
  Shareholders
  
X
Co 1

Y
Z

Shareholders

X
Co 2

Y
Z
```

Companies that are less than 100 per cent commonly owned may be permitted to consolidate where there is a variation of not more than three per cent in common shareholding due to shares held by employee share purchase schemes approved under s IC 4.

There is no requirement to include the parent company in the regime. This means a consolidated group may comprise associated subsidiaries that are wholly-owned.

(3) Same balance date
A group of companies cannot consolidate unless they all have one common balance date. This ensures that the group’s income for any income year relates to the same period, not to an amalgam of different periods. Where a group has several tax balance dates, they must decide on one tax balance date [s FM 31(4)].

(4) Qualifying companies
A qualifying company cannot consolidate with a non-qualifying company. Therefore, all companies in a group must be qualifying companies or all companies must be non-qualifying [s FM 31(2)].

(5) Mining companies
A mineral mining company may only form a consolidated group with other mineral mining companies. A mining company is a company whose sole or principal source of income is from mining minerals, or whose sole or principal activity is mineral exploration [ss FM 31(2), CU 22].
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(6) **Arrangement to defeat purpose of regime**
Companies are not able to consolidate if any shares in those companies have been subject to an arrangement or series of related or connected arrangements, or had any rights attaching to those shares extinguished or altered, directly or indirectly, for the purpose of enabling the companies to form a consolidated group so as to defeat the intent and application of the consolidation rules [s FM 31(6)].

**190.15 Formation of a consolidated group** [ss FM 35, FM 38]
A group of companies that wishes to consolidate must give Inland Revenue written notice (on Inland Revenue Form IR494) of their election to form a consolidated group. The notice must contain:

(a) An undertaking by each company to be jointly and severally liable for the group’s income tax liabilities; and

(b) Nomination of an agent or “nominated company” of the group.

Generally, a company commences being treated as a member of a consolidated group:

(a) From the start of the income year in which it notifies Inland Revenue, provided it gives this notice within 63 working days of the start of that income year; or

(b) In any other case, from the start of the following income year.

There is special provision for a group of newly incorporated companies to be treated as a consolidated group from the beginning of the income year of incorporation and formation, provided they notify Inland Revenue within 63 working days of the latest of those incorporations.

There is also a special provision allowing a group of companies that have become entitled to form a consolidated group during an income year to be treated as a consolidated group from the day of first entitlement, provided they notify Inland Revenue within 63 working days of the first entitlement.

An anti-avoidance provision prevents groups consolidating during an income year, instead of at the start of the year, where there is an arrangement to abuse the regime.

Companies that form a consolidated group during an income year rather than from the start of an income year must furnish a set of part-year accounts in the return for that year.

**Example:**
Tomcat Ltd and Jerry Ltd become wholly-owned on 1 July 20X1. The group has a 31 March balance date. The group elects to be a consolidated group within 63 working days of first becoming commonly owned. Consolidation commences on 1 July 20X1. Part-year accounts are required for the period 1 April to 30 June 20X1.

Inland Revenue may accept notification given outside the 63-day period if the CIR is satisfied that the notice of election could not reasonably have been furnished earlier.

**190.16 Entering an existing group** [ss FM 36, FM 38]
The rules for entering an existing consolidated group are similar to those for forming a consolidated group.

A company electing to join an existing consolidated group must give the CIR a written election notice (on form IR495) which contains an agreement to be jointly and severally liable for the group’s income tax.

A company that joins an existing consolidated group generally commences being treated as a member of the group:

(a) From the start of the income year in which it notifies Inland Revenue, provided it gives this notice within 63 working days of the start of the income year; or

(b) In any other case, from the start of the following income year.

A newly incorporated company can join an existing group from the beginning of the income year of incorporation provided it notifies Inland Revenue within 63 working days of incorporation.

A newly acquired company can also join an existing consolidated group from the day it becomes entitled to become a member, provided it notifies Inland Revenue within 63 working days of entitlement.
An anti-avoidance provision prevents companies joining a consolidated group partway through an income year, rather than from the start of the year, where there is an arrangement to abuse the regime.

Companies that join a consolidated group during an income year must furnish a set of part-year accounts in the return for that income year.

Inland Revenue may accept notification given outside the 63-day period if the CIR is satisfied that the notice of election could not reasonably have been furnished earlier.

**190.20 Joint and several liability**  [ss FM 3, FM 4, FM 5]

A company forming or joining a consolidated group must give an undertaking to be jointly and severally liable for the group’s income tax. This includes provisional tax, PAYE, RWT, NRWT, ESCT, and FBT. There are limited provisions for relaxation of the joint and several liability.

The requirement for joint and several liability may be limited to one or more companies of the group, when the group makes its election. Election is made on form IR495. In this case the CIR must be satisfied that the company or companies bearing liability for the group tax have sufficient assets to meet the group’s tax liability. The reason for this provision is so that groups of companies with financial arrangements subject to negative pledge clauses can still consolidate. If the companies liable for the group tax default in paying it, the CIR may raise separate assessments on the companies excluded from joint and several liability for the amount of the group tax liability attributable to them. The excluded companies would thus be liable for their share of the group tax in the event of a default.

Joint and several liability may be removed from a company that leaves a consolidated group if the CIR is satisfied that removing such liability would not significantly prejudice the collection of income tax.

**190.25 Nominated company**  [ss FM 34, FM 40, FM 32]

The nominated company must be a member of the consolidated group. The group can change which company is the nominated company by sending written notice (on form IR495), to Inland Revenue. Where there are changes to the group, the role of the nominated company may be significant. For example, if two members in a consolidated group of four companies become wholly-owned by new owners, it is possible for both groups to claim continued consolidated group status. To overcome this potential problem, the group of which the nominated company is a member continues as the consolidated group. Tax consequences are therefore not triggered for that group.

Where a company is a member of more than one consolidated group at any time, it is treated as a member only of the first consolidated group it joined, as long as it still meets the requirements for being treated as a member of that group [s FM 32].

**190.30 Leaving a group**  [ss FM 37, FM 39, FM 40, FM 41, FM 42]

A company may leave a consolidated group voluntarily by sending Inland Revenue a written election (using form IR495), to cease being treated as a member. The company’s membership ceases from the beginning of the income year after the year Inland Revenue receives the notice if so requested in writing. Otherwise the company is treated as a non-member from the beginning of the income year in which Inland Revenue receives the notice.

There are also provisions which deem a company in certain circumstances to have ceased being a member of a group. These circumstances are when:

(a) The company ceases to be an “eligible company” as defined.

(b) The company ceases to be entitled to be a member of the same consolidated group as the nominated company.

(c) The consolidated group to which a company belongs ceases to have a nominated company. However, if the nominated company of the group is wound up and Inland Revenue receives notice within 20 days of the wind up that another company is to be the new nominated company, the company does not cease to be a member. The CIR has discretion to accept a notice after the 20-day period.
In the first two of these situations the company is treated as a non-member from the beginning of the income year in which the deemed cessation occurs, or from the date of deemed cessation if the company specifically requests this in writing. However, Inland Revenue declines this request where tax avoidance is involved.

In the third situation above, the company is treated as having ceased to be a member from the beginning of the income year in which the deemed cessation occurs if there is no new nominated company within the 20-day period.

Where a cessation date occurs partway through an income year, the company leaving the group must furnish part-year accounts for that income year [see 190.35].

A company that ceases to be a member of a consolidated group through being wound up is treated as having ceased to be a member from the date of winding up. This is not conditional on adequate accounts being furnished.

190.35 Part-year accounts [s FM 14]

A company that enters or leaves an existing consolidated group partway through an income year must furnish part-year accounts. These are necessary because the company becomes a different tax entity and is subject to different tax rules in the income year of entry or exit. The company should include these part-year accounts in its tax return for that year and file it by the usual due date.

Example:

If a company with a 31 March balance date joins a consolidated group three months into its income year, it must furnish a set of part-year accounts with its return for that income year. The part-year accounts replace the normal full year accounts that would otherwise have been furnished.

The company’s net income is calculated (to a fair and reasonable extent and with any necessary modifications) by treating the part-year as a complete income year. Where accounts cover six months they should include only half the normal allowable deductions for items such as depreciation or amortisation. As the part-year is treated as a complete income year, the net income or net loss of the separate part-year periods are not netted off. This is relevant in determining part-year net losses and profits for carry forward and offset [see 940 LOSSES].

Example:

ABC group is a consolidated group which DCo joins on 30 September 20X1. Both ABC group and DCo have 31 March balance dates. On an individual taxpayer basis DCo determines its income to 30 September 20X1 and includes it in its own return for the income year ended 31 March 20X2. DCo’s pre- and post-consolidation results are not offset against each other. If the pre-consolidation result was a loss of $100 and the post-consolidation result attributable to DCo is a profit of $90, DCo is allowed a pre-consolidation loss of $100. It would not be limited to $10.

190.40 Returns, assessments, and liability of consolidated group [s FM 3]

A consolidated group files one tax return, receives one notice of assessment, and consequently has only one tax liability for any income year. A consolidated group files one tax return which includes the total net income for all companies in the group. The group files that return under an IRD number that is separate from the individual companies’ IRD numbers. The member companies do not have to file separate returns unless these are needed because of part-year consolidations.

The CIR can grant an extension of time for filing the consolidated group’s tax return under s 37 of the TAA. The CIR has discretion to determine what information (in addition to the consolidated tax accounts) Inland Revenue needs to enforce the consolidation regime and the ITA generally. A consolidated group receives only one income tax notice of assessment, based on the tax return it files. Separate notices of assessment are not issued unless they are required by part-year consolidations.

Subject to the usual quarantining rules, the groups total taxable income is calculated before taking into account available credits (foreign tax credits and CFC credits). This means the credits belonging to individual companies that do not have any New Zealand taxable income can be offset against the income of other companies in the group. In this way, the group can use credits that would otherwise not be available. On the other hand, where the credits are attributed to individual group members that have taxable income but the
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190.41 Calculating group taxable income [ss FM 3, FM 8, FM 9, FM 10, FM 11, FM 12, FM 13]

A consolidated group calculates its taxable income as the sum of the member companies’ taxable incomes, with some special rules applying to:

(a) Intra-group items of income and expenditure;
(b) Treatment of the consolidated group as a single company; and
(c) The determination of thresholds on a group level.

(1) Assessable and deductible items

Assessable and deductible items arising from intra-group transactions are not included in the determination of group taxable income, except for transactions involving:

(a) Disposition of trading stock;
(b) Base price adjustment under the financial arrangement rules; and
(c) Dividends arising from pre-consolidation debt remissions.

This results in intra-group transactions being treated as transactions between branches of the same company, so that there are no taxation consequences.

Only items that would not be income if the group were a single company are not taken into account. This ensures that income arising from transactions with a third party outside the consolidated group, but as part of an intra-group arrangement, is included in the calculation of the group’s taxable income.

Similarly, only those expenses that would not be an allowable deduction if the group were a single company are not taken into account. This ensures that intra-group expenses (including reimbursement between group members for fringe benefits provided) are not allowable deductions. In the case of outlays to a third party (such as fringe benefit tax paid), the expenses are allowed as a deduction.

Example:
ParentCo engages a third party to provide management consultant services. ParentCo on-charges the fees to SubCo. SubCo is a land-holding company deriving no income. ParentCo is not allowed a deduction for the management fees paid to the third party.

(2) Administration expenses of holding company deductible

Deductions are allowed for administration and other expenses of a holding company regardless of whether the holding company itself derives any income. This is because those expenses would be allowable deductions of that consolidated group if it were treated as a single company. However, one qualification is that a nexus must exist between that expenditure item and the derivation of gross income or business activity of another member of that consolidated group. This prevents deductions being allowed to a non-operating consolidated group of companies.

(3) Expenses not allowed as a deduction if group is a single company

Consistent with the treatment of a consolidated group as a single company, expenses which would be deductible to the member but not to the group are not deductible. Interest deductible under s DB 7 is the only exception. This permits a deduction for interest on money that one member borrowed from outside the group so that another group member could purchase at least a 66 per cent shareholding of a third group company. The group must demonstrate a clear and direct link between the borrowing and the intra-group loan used to purchase equity in a manner that meets the requirements of s DB 7.

Example:
SubCo 1 and SubCo 2 are members of a consolidated group. SubCo 1 has tax credits of $100 from tax it has paid overseas and a taxable income of $1,000. SubCo 2 makes a loss of $1,800. Therefore, on a group basis there is a net loss of $800. The $100 tax credits are not available for offset to the group.
Example:
ABC consolidated group purchases land. The land is legally held by subsidiary C as a revenue asset. Parent A uses the land for its head office. Subsidiary C is not allowed a deduction for expenses incurred in acquiring the land.

(4) Income assessable if group is a single company [s CV 2]
Any profit or gain that would not be included in income when derived by a member but which would be income if derived by the consolidated group as a single company is included in the calculation of the group’s taxable income. This provision is intended to prevent intra-group arrangements to transfer assets and recharacterise them to avoid tax. This provision is similar to the provision in s CV 1 aimed at preventing group structuring to avoid tax from certain activities.

(5) Capitalisation of group costs of improvements to fixed assets
Non-deductible expenditure that a group member incurs in relation to an asset held by another group member may be capitalised.

Example:
In consolidated group ABC, ACo owns a building. BCo makes some capital improvements to the building. The cost of those capital improvements can be added to the costs incurred by the owner, ACo.

(6) Threshold levels determined on group basis [s FM 2]
Where a provision of the ITA specifies a threshold, the position of the group is to be determined as if the consolidated group is one entity.

Example:
Consolidated group ABC wants to know under what circumstances it may invoke s EW 17 and use the straight line method of calculating income or expenditure. Section EW 17 permits a straight line method of calculation if the total value of all financial arrangements is less than $1.5 million. Assume each member in ABC group has less than $1.5 million of financial arrangements, but the group as a whole has financial arrangements with a combined value of over $1.5 million. ABC group may not use the straight line method as the group exceeds the threshold value of financial arrangements.

190.45 Dispositions of property [s FM 15, FM 16, FM 17, FM 18, FM 19, FM 20, FM 21, FM 22, FM 23]
A comprehensive set of asset transfer rules applies to intra-group transfers of assets. Generally, no tax is payable on intra-group transfers of assets other than trading stock.

Tax becomes payable in relation to the intra-group transfers when the transferred asset is sold out of the group. Consistent with the treatment of the consolidated group as one entity with separate branches, selling shares of a company in the group that holds the transferred asset constitutes a sale of the asset out of the group. This is to prevent the consolidation regime from being abused.

Example:
In FGH Group, FCo shares are sold to a third party. At the time of sale, FCo is holding land assessable under s CB 6 which GCo transferred to it. The difference between the transferred asset’s market value at the time of the share sale and the deemed transfer value is included in the return of income by the group.

The rules applying to various types of assets follow.

(1) Financial arrangements [ss FM 18, FM 19, FM 20]
Generally, s EW 29 requires a base price adjustment for any transferred asset in order to allocate income or expenditure from the transferred financial arrangement between the transferor and the transferee in the year of transfer. An intra-group transfer of a financial arrangement would require a base price adjustment.

Section FM 18 specifies the deemed consideration for the transfer so that it does not result in any allocation of income or expenditure between the transferor and transferee for the year of transfer. To qualify, both parties must use the same method of allocating income or expenditure (for example, yield to maturity basis) and meet certain conditions. These conditions are:
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190.45(2)

(a) Election by the nominated company of a nil allocation;
(b) The transferor and transferee are members of the same consolidated group for the whole income year of transfer; and
(c) Neither company is entitled to carry forward pre-consolidation losses, unless the group’s income is sufficient to absorb all such losses.

Where the group does not meet these conditions, but there is no change in the method of calculation, it must make a fair and reasonable allocation for the year of transfer [s FM 19]. Where there is a change in the calculation method, the transferor is deemed to have transferred the financial arrangement at market value [s FM 20].

(2) Trading stock [s FM 17]

Unlike the tax treatment on intra-group transfers of other assets, intra-group transfer of trading stock are generally not ignored for tax purposes. Instead, such transfers are deemed to occur at the transferor’s tax value, or at cost for new purchases. However, the nominated company may elect (on Inland Revenue Form IR495) to have transfers ignored according to the general asset transfer rules for all or certain lines of trading stock, provided that the trading stock in question and its ownership can be specifically traced.

(3) Depreciable assets [s FM 15]

Depreciation recovery or further deductions under the ITA are generally based on the tax book value plus subsequent capitalised costs.

Example:
Assume an ice-cream plant is transferred within FGH group. A tax event occurs on the sale of the ice-cream plant out of the group. The details are as follows:

| Purchase date | 1 April 20X1 |
| Transfer date | 31 March 20X2 |
| Tax event | 1 April 20X3 |
| Purchase cost | $10,000 |
| Tax book value on transfer date | $8,000 |
| Consideration for transfer | $8,500 |
| Market value at tax event date | $7,000 |
| Tax book value at tax event date | $6,400 |
| Depreciation recovered | $600 |

The consideration passing between the companies for the transfer is irrelevant. Depreciation is calculated on the tax book value on transfer.

Where depreciable property acquired under a binding contract entered into before 16 December 1991 is transferred intra-group, the depreciation rates prevailing for the 1992-1993 income year continue to apply.

A pool of property may be transferred at its adjusted tax value where the whole pool is transferred intra-group. Where only part of the pool of property is transferred, the lower of the market value of the part of the pool being transferred or the adjusted tax value of the whole pool is the deemed transfer price.

(4) Other assets

Any other assets such as land and revenue assets are deemed to be transferred intra-group at cost to the transferor, including expenditure incurred in purchasing or improving the assets and legal costs in improving legal rights in relation to that asset.

Where an asset is transferred intra-group as part of another asset (rather than in its original form) and its market value cannot be determined, there is provision for its market value as at the time prior to absorption to be taken into account.
(5) **Adjustment on sale of shares on revenue account** [s FM 23]
Where a parent company has consolidated with a subsidiary and the shares in the subsidiary are held on revenue account, any gain or loss on the sale of the subsidiary shares would be determined as assessable income or deduction under normal income tax rules. An adjustment applies to the sale price to take account of any exempt intra-group transaction. Without the adjustment a deduction for “losses” on sale of the shares would be “incurred”.

**Example:**
ParentCo and SubCo are members of a consolidated group. ParentCo’s shares in SubCo are held on revenue account. The purchase price of the shares was $2 per share. While a consolidated member, SubCo transfers most of its assets to ParentCo. This results in a lower share market price of $1 per share. ParentCo sells its shares in SubCo to a third party. The sale price is adjusted to $2, and no loss is available to the group.

(6) **Anti-avoidance provision** [s FM 22]
Section FM 22 is aimed at consolidated groups which consolidate for a brief period solely to obtain the benefit of tax-free asset transfers. In that situation, the transfers are recognised and included in the group’s income.

**190.51 Gift duty**
No gift duty is payable on asset transfers within a consolidated group. Unlike the treatment for income tax, gift duty does not become payable at a later date when the asset is transferred out of the group.

Another provision prevents gift duty becoming payable on transactions between companies, if these transactions constitute dividends.

**190.55 Loss carry forward and grouping** [ss ID 1, ID 2, IS 1, IA 9]
The loss carry forward provisions apply with modifications to a consolidated group as if it were one tax entity. The grouping provisions are also modified to apply to the group as one tax entity. Any loss the consolidated group incurs is treated as net loss of the group. The provisions relating to loss carry forward and loss grouping of consolidated groups do not apply to groups consisting of mining companies [ss IS 1, ID 1(2)].

Any net loss that a company has before it becomes a member of a consolidated group remains that of the member. The member’s pre-consolidation net losses are offset against group net income. The limits on the offset are discussed below.

The member’s pre-consolidation net losses that are not offset against group net income, may be either:
(a) Carried forward for offset against the company’s future net income when it leaves the group; or
(b) Offset to a company 66 per cent commonly owned with it, including another consolidated group.

The consolidated group net losses and pre-consolidation net losses carried forward are offset on a “first in, first out” basis. Where these net losses arise in the same income year, the consolidated group can notify the CIR of the order in which the losses are to be used. In the absence of such notification, the losses are pro-rated [s IA 9].

**Example:**
SubCo 1, SubCo 2, and ParentCo are the members of a consolidated group. SubCo 1 and SubCo 2 have pre-consolidation net losses for the 20X1 income year of $100 and $200 respectively. The group has net income of $200 in the 20X2 income year. The net losses offset against group net income are pro-rated one-third from SubCo 1 and two-thirds from SubCo 2.

**190.56 Limited loss offset where members not a group at all times** [ss ID 4, ID 5]
Under ordinary loss offset rules, a net loss may be offset provided the group existed from the year in which the net loss arises through to the income year of offset. In a consolidated group of members that was not a 66 per cent commonly owned group at all times, the amount of net loss is restricted to the lesser of:
The amounts that the company incurring the pre-consolidation loss ("loss company") is permitted to carry forward; and

The amount permitted to be offset against net income of those members that formed a 66 per cent commonly owned group with the loss company at all relevant times.

The net incomes of the loss company and the other group members (66 per cent commonly owned) in the year of consolidation are calculated in accordance with s FM 6 on a single company basis.

Example:
A consolidated group comprises A Co, B Co, and C Co. A Co has pre-consolidation net losses of $1,000 (incurred in the 20X3 income year). B Co was 66 per cent commonly owned with A Co at all times. C Co was not 66 per cent commonly owned with A Co during the 20X1, 20X2, and 20X3 income years. In the 20X4 income year (first year of consolidation), the consolidated group has net income of $1,200 comprising $300, $300, and $600 arising from A Co, B Co, and C Co respectively. The amount of loss that may be deducted is determined as follows:

<table>
<thead>
<tr>
<th>A Co’s net income in 20X4</th>
<th>$300</th>
</tr>
</thead>
<tbody>
<tr>
<td>B Co’s net income in 20X4</td>
<td>$300</td>
</tr>
<tr>
<td>From the available net losses of A Co ($1,000)</td>
<td>$600</td>
</tr>
</tbody>
</table>

No offset can be made against the income of C Co as that company did not form a group with A Co at the time at which A Co’s loss was incurred.

Where a company with pre-consolidation net losses is a member for only part of the consolidated group’s income year, the amount of loss offset against the consolidated group’s income is also restricted, taking into account any net income derived in the part-period before consolidation. Section ID 2 takes into account the possibility that the loss company may have been a member of another consolidated group in the part-period before consolidation. Accordingly, the amount of net loss offset is restricted to the lesser of:

(a) The amount of pre-consolidation net loss to be carried forward against group net income, less any net income of the company or another consolidated group of which the loss company was a member during the part-year period before consolidation; and

(b) The part-year net income of the consolidated group.

Example:
A Co left XYZ group to join ABC group midway through the income year. The net incomes for the relevant periods are:

<table>
<thead>
<tr>
<th>A Co (available net loss)</th>
<th>$1,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Co (net income)</td>
<td>Nil</td>
</tr>
<tr>
<td>XYZ Group (income)</td>
<td>$400</td>
</tr>
<tr>
<td>ABC Group (income)</td>
<td>$500</td>
</tr>
</tbody>
</table>

The lesser of:

(a) $1,000 − (0 + 400) = $600; or
(b) $500,

may be carried forward. Only $500 may be carried forward.

Where pre-consolidation net losses are carried forward against future consolidation net income, for the purposes of s IP 3 the net income of the consolidated group is treated as if it were the net income of the loss company.

190.60 **Attributed CFC income and FIF income** [ss IQ 1, IQ 4, IQ 6, IQ 7, IQ 8]

Only New Zealand resident companies are eligible to consolidate. Members of a consolidated group with interests in controlled foreign companies (CFCs) and foreign investment funds (FIFs) must include in the consolidated group’s income any attributed CFC income and FIF income. For this purpose, the provisions of subpart IQ (relating to CFCs and FIFs) apply as if the consolidated group were one company.
Any tax credit becoming available or any attributed CFC loss or FIF loss incurred is treated as becoming available to or incurred by the consolidated group. There are some modifications to the ring-fencing rules [ss IQ 4(3), IQ 5(3)].

A member’s pre-consolidation tax credits, attributed CFC loss, and FIF loss remain in the ownership of the member company, but they may be carried forward and offset against the consolidated group income subject to the normal quarantining rules. The order of offset is similar to that applicable to other losses [see 190.56]. A member’s pre-consolidation tax credit, attributed CFC loss, and FIF loss may be:

(a) Offset against the group’s income tax or attributed CFC income or FIF income, subject to the quarantining rules;
(b) Credited, deducted, or set off against future income tax payable or income derived by the member when it leaves the consolidated group or joins another group;
(c) Carried forward by the member company to future income years; or
(d) Offset against income tax payable by, or income of, any other company (other than the consolidated group) as permitted under the ITA.

Like other losses, the group’s tax credits, attributed CFC losses, and FIF losses are offset on a “first in, first out” basis. Where the losses are incurred in the same income year, the losses are pro-rated.

Example:
ACo, BCo, and CCo are the members of consolidated group ABC. ACo and BCo have pre-consolidation attributed CFC losses of $100 and $200 respectively, carried forward from the 20X1 income year in respect of their Hong Kong companies. The consolidated group has attributed CFC income from Hong Kong in the 20X2 income year of $200. The losses are pro-rated one-third from ACo and two-thirds from BCo.

190.61 Limited tax credit where members not a 66 per cent commonly owned group [ss LK 8, LK 10]

Where the members of a consolidated group were not members of a 66 per cent commonly owned group when a tax credit arose, s LK 10 restricts the amount that may be offset to the aggregate of:

(a) The amount of the tax credit or loss permitted to be carried forward by the company to a subsequent year; and
(b) The amount permitted to be offset against tax payable or income of other member companies that were at all relevant times members of a 66 per cent commonly owned group.

The income tax payable and the income of the companies in the year of consolidation is determined by applying s FM 3 (that is, on a single company basis).

190.62 Limited tax credits on part-year consolidation [ss LK 8, LK 11]

Where a company is a member of a consolidated group for only part of an income year, the amount of tax credits that may be offset are restricted to take into account the company’s income tax payable or income derived in the part-period before it joined the group. The amount of offset is restricted under s LK 11 to the lesser of:

(a) The amount of pre-consolidation tax credits to be credited against the group’s income tax payable (or loss to be deducted against the group’s income), less any income tax payable (or income derived) by the member (or by another consolidated group of which it was a member) during the part-period before it joined the group; and
(b) The amount of income tax payable (or income derived) by the consolidated group that can be reasonably and fairly attributed to the part of the income year during which the newly joined company was a member of the consolidated group.

The income tax payable or income derived is calculated by applying the provisions in s FM 14 in relation to part-year accounts.
190.65 **Consolidated group provisional tax** [ss RC 28, RC 29, RC 30, RC 31]

A consolidated group’s provisional tax payable is determined by applying the provisions in subpart RC as if the consolidated group were a single company.

Companies forming or joining a consolidated group must give an undertaking to be jointly and severally liable for the consolidated group’s income tax. This extends to provisional tax. However, where a group has approval for joint and several liability to be limited under s FM 4 to one or more of its companies, the provisional tax liability is also modified.

In the first year of consolidation and in any income year in which there are new members, calculating the group’s provisional tax relies on the residual income tax (RIT) that each member incurred in a preceding income year before becoming a consolidated group member. Section RC 29 requires the consolidated group to include in its RIT for the preceding year the proportion of the individual company’s income for the preceding year which reflects the proportion of the provisional tax year in which the company was a member of the consolidated group.

**Example 1:**
XCo joins XYZ consolidated group on 1 April 20X1. The group has a 31 March balance date. XCo was a member for 12 months during the 20X2 income year. XYZ group must include 12 months of RIT derived by XCo in the 20X1 income year (plus five per cent uplift) in its provisional tax calculations for the 20X2 provisional tax year. XCo makes no payment of provisional tax individually.

**Example 2:**
YCo joins consolidated XXX group on 8 July 20X1. XXX group has a 31 March balance date. YCo and the group made their first instalments of provisional tax separately. When YCo joins the group, XXX group must recalculate the preceding year’s RIT for its subsequent instalments of provisional tax. YCo’s provisional tax liability for part of the year is squared up at year end and it does not have to pay any further provisional tax.

Where a company was a member of a consolidated group for all or part of a year and ceases to be a member for all or part of a succeeding year, it must estimate its provisional tax, with associated penalties for underestimation. The consolidated group may estimate down its provisional tax payment.

In respect of the GST ratio method of provisional tax calculation, ss RC 8, RC 9(6), RC 11, and RC 15 to RC 19 apply to the consolidated group with the following modifications:

(a) The group uses the GST ratio method and a new company joins the group:
   (i) If a new company joins at the start of the tax year and, as a result, the $150,000 threshold for using the method is exceeded, the group is no longer eligible to use a GST ratio;
   (ii) If a new company joins at the start of the tax year, and the group, allowing for the inclusion of the company, is eligible to use the GST ratio method, but the ratio must be recalculated;
   (iii) If a new company joins during the tax year, the group may continue to use the GST ratio method for the remainder of tax year, but the ratio must be recalculated. Eligibility ceases if the threshold for use of the method is exceeded;

(b) The group does not the GST ratio method and a new company which uses the GST ratio method joins the group. Where the consolidated group does not calculate its provisional tax using the GST ratio method and a new company that does use the GST ratio method joins the group, the group is precluded from using the GST ratio method for that tax year;

(c) Calculating the new ratio when a new company joins the group:
   (i) The recalculation of the GST ratio must include the residual income tax of the new company for the preceding tax year and the total taxable supplies of the company for the corresponding income year; and
   (ii) the recalculated GST ratio applies to provisional tax payments made on or after the date on which the company joins the group;
190.70 Withholding tax obligations

Joint and several liability for the consolidated group’s income tax extends to resident withholding tax (RWT), non-resident withholding tax (NRWT), fringe benefit tax (FBT), employer superannuation contribution tax (ESCT) and tax deductions under Part R, including PAYE deductions [s FM 3]. However, the members are individually responsible for complying with their respective obligations, such as filing individual returns.

190.75 Imputation credits [subpart OP]

The consolidated group must maintain its own separate imputation credit account (ICA) covering the group’s activities. The opening balance of a newly formed group ICA is nil. An existing consolidated group’s opening balance is equal to the closing balance of the preceding imputation year. The ICA of each member in the group is maintained separately from the group ICA. The individual ICAs generally record the balance to the date of consolidation. Debits and credits arise to the ICA in the same way as for individual companies, but by treating the consolidated group as if it were a single company [see 670.420].

190.76 Debiting and crediting between consolidated group and individual companies [s OP 22]

Post-consolidation credits and debits arising to the group ICA do not arise to the individual ICAs.

A transfer from the individual ICAs to the group ICA is made when a debit arises to the group ICA and that debit is not offset by any group credit that arose earlier or on the same date as the credit in the individual ICA. The ordering procedure in s OP 22(3) applies to the group credits. When a credit transfer occurs, a corresponding debit arises to the individual ICA.

The ordering procedure also applies to the individual credits in the individual ICAs that are transferred. The “first in, first out” rule applies. If two or more credits arose at the same time, the consolidated group may elect which credit to offset. Where no election is made, the credits are offset on a pro-rata basis.

Example:

ACo and BCo are members of ABC Group. Both companies have pre-consolidation credit balances and, in particular, credits of $100 and $200 which arose at the same time (5 July 20X1). On 10 October 20X4 a debit of $100 arises to the group ICA which is not offset by any group credit. Assume no election is made. The credits from ACo and BCo are offset proportionately, that is, one-third from ACo and two-thirds from BCo.

If a debit were to arise to the individual ICA account and cause or increase a debit balance, that debit does affect the company’s ICA but is debited to the group ICA. In this way the individual member does not have to pay further income tax.

An amount of further income tax that a consolidated group member pays may be credited against the group’s income tax payable. To the extent that it is so credited, the credit is not available to the individual member.

190.77 Application of specific imputation provisions to consolidated groups [ss OB 60, OB 61, FN 6, GB 38]

The benchmark dividend rules in ss OB 60 and OB 61 apply to a consolidated group as if it were a single company. However, and intra-group dividends are not taken into account for the purposes of these rules. This means that the imputation ratio and benchmark dividend rules apply to all dividends except intra-group dividends paid by each member in the group. The attachment of imputation credits to intra-group dividends is optional.

A consolidated group’s nominated company is responsible for ensuring that the group furnishes annual imputation returns as well as imputation returns whenever requested by the CIR, or as otherwise required [s FN 6].

The provisions relating to further tax payable and imputation penalty tax apply to the group as if it were a single company and references to a company apply as references to a consolidated group.
Under s GB 38, where an arrangement is entered into (as specified in s GB 37), whereby a shareholder of a company in a consolidated group is paid (directly or indirectly) a dividend by another company in the group, the dividend is deemed to have been paid by the first company and any imputation credits attached to that dividend:

(a) Do not form part of the income of the shareholder;
(b) Are not eligible for a credit of tax or a carry forward of loss; and
(c) Are a debit to the ICA of the first company under ss OB 30 and OP 28.

Section GB 38 also provides that the anti-avoidance provisions in ss GB 35 and GB 36 apply to the consolidated group as if it were a single company and references to provisions of the ITA are references to the equivalent consolidation provisions. These anti-avoidance provisions are explained in more detail in 670 IMPUTATION.

**190.90 Policyholder credit accounts** [ss OP 109, OP 110, OP 111, OP 112, OP 113, OP 114, OP 115, OP 116, OA 7]

A consolidated group must maintain a group policyholder credit account (PCA) if any member of the group is carrying on a business of providing life insurance. The group’s account is maintained separately from the individual PCA account.

The opening balance of a newly formed consolidated group’s PCA is nil. An existing group’s opening balance is equal to the closing balance of the preceding imputation year.

Credits arise in the group’s PCA as follows:

(a) Opening credit balance (arises 1 April) [s OA 7];
(b) Transfer of a credit balance from the group’s imputation credit account (arises on the day on which the ICA is debited for the transfer) [s OP 110];
(c) A credit transferred from a group company’s policyholder credit account (arises on the day on which the group company’s PCA is debited) [s OP 112].

Debits arise in the group’s PCA as follows:

(a) Opening debit balance (arises 1 April) [s OA 7];
(b) A credit balance applied to satisfy a policyholder base income tax or provisional tax liability for income year (arises on the last day of the income year [s OP 115]; and
(c) A credit balance transferred to the imputation credit account (arises on the day of election) [s OP 116].

**190.91 Debiting and crediting between group and individual PCAs** [s OP 112]

Credits may be transferred from the individual PCAs to the group PCA. A transfer is made when a debit arises to the group PCA and that debit is not offset by any group credit that arose earlier or on the same date as the credit in the individual PCA. An ordering procedure applies to the group credits. When a credit transfer occurs, a corresponding debit arises to the individual PCA. The ordering procedure also applies to credits in two or more individual PCAs that are transferred. The “first in, first out” rule applies. If two or more credits arose at the same time, the consolidated group may elect which credit to offset. Where no election is made, the credits are offset on a pro-rata basis.

**190.92 Application of PCA provisions to consolidated groups** [ss OP 115, OP 116]

A consolidated group may elect to use any credit balance in the group PCA in payment of income tax payable on policyholder income the group derives. The election is made by recording the amount of the credit as a debit to the group’s PCA.

The group may also elect to transfer the credit balance in the group PCA to the group ICA.
Sections OJ 9 and OA 2(5) (relating to elections to use a credit balance to reduce income tax and determinations by the CIR on PCA debits and credits) apply as if references to a PCA company and the PCA provisions were references to a consolidated group and to equivalent consolidation provisions.
Chapter 200

Compensation and Damages

200.10 Compensation to fill a “hole in profits”

It is necessary to have regard to the real nature of the loss or injury sustained by the recipient for which the compensation is received in determining whether or not an amount received as compensation on the cancellation of a contract constitutes income. Is the compensation to make good a loss of trading profits, or is it to recompense for the deprivation of a capital asset?

In *Burmah Steam Ship Co Ltd v Commissioners of Inland Revenue* [1931] SC 156, (1931) 16 TC 67, the question arose as to whether damages received by shipowners from the repairers for failure to execute repairs within an agreed time constituted assessable profits. The failure of the repairers had the result of depriving the shipowners of the opportunity of putting the vessel to immediate profitable use in their business, thus making, so to speak, a “hole in the profits”, and damages received went to fill that “hole” and were held to be assessable.

Compensation received in the following circumstances, using the same principle, has been held to be a trading receipt in the ordinary course of business and assessable [s CB 1]:

(a) Compensation received by a shipbuilding company on the cancellation of a contract to build ships: *Short Bros v Commissioners of Inland Revenue* (1927) 12 TC 955.

(b) A sum received from auditors to make good defalcations of employees which the audit had failed to detect: *Gray v Penrhyn* [1937] 3 All ER 468.

(c) A sum awarded for the compulsory taking over of a company’s stock of rum by the Admiralty: *Commissioners of Inland Revenue v Newcastle Breweries Ltd* (1927) 12 TC 927.

(d) A sum recovered from insurers by a timber company on the destruction by fire of their stock of timber: *J Gilksten & Son Ltd v Green* [1929] AC 381, (1929) 14 TC 364 (HL).

(e) Compensation received by commission agents on the cancellation of an agency agreement which had only one year to run: *Kelsall Parsons & Co v Commissioner of Inland Revenue* [1938] SC 238, (1938) 21 TC 608.

(f) A lump sum received as compensation for cancellation of a contract to pay commission where a commission agency was outside the company’s usual line of business: *Shove v Dura Manufacturing Co Ltd* (1941) 23 TC 779. This case indicates that contracts in the ordinary course of a trader’s business connotes contracts of a trading nature and not contracts which form the bulk of the trade. If the proceeds of a contract are of a revenue nature it makes no difference whether a contract is usual or not. A contract does not become a capital asset because it is a contract in a new or unusual line of business.

(g) Compensation received by shipowners for compulsory detention of ships by the Government: *Ensign Shipping Co Ltd v Commissioners of Inland Revenue* (1928) 12 TC 1169.
(h) A lump sum payment made to an employee to compensate for changes in conditions of her employment (withdrawal of the right to trade union membership): *Hamblett v Godfrey* (1987) BTC 83.

(i) An Education Department payment received by a school teacher, being compensation for wages lost as a result of school governors unlawfully refusing to employ the teacher: *TRA Case L94* (1989) 11 NZTC 1,542.

(j) Compensation payments by the Fruit Marketing Council to fruitgrowers for hail damage, which are made with the intention of restoring, to some extent, revenue losses caused through hail damage to enable fruitgrowers to meet their outgoings.

(k) Compensation received by dairy farmers who have cattle slaughtered because of brucellosis. This is income in the year in which the cattle are slaughtered.

(l) Compensation for loss of a capital asset, if the compensation can be regarded as compensating for loss of income, eg, compensation paid to a subdivider upon the compulsory acquisition of land as the subdivisional profits would have been taxable: *Duff v Commissioners of Inland Revenue* (1982) 5 NZTC 61,131 (CA).

(m) Compensation paid by the Government for timber royalty and business income lost by a farmer as a result of a ban on the export of indigenous timber. This is because the compensation takes the place of the revenue receipts which would have been received from the logging and export of timber: *TRA Case T47* (1998) 18 NZTC 8,319.

A company which carried on the business of theatrical agents and producers of plays, purchased the production of a play, imposing certain restrictions on the vendor as to the sale of motion picture rights during the currency of the agreements. Damages received for breach of this agreement were held to be liable to tax. The nature of the respondent company’s business was such that the acquisition of the licence to produce plays was an ordinary incident of their business. The acquisition of each licence to produce a particular play did not constitute that licence a capital asset, but merely the acquisition of the stock-in-trade, while the sum of money awarded as damages for breach of contract was really compensation for loss of profit otherwise receivable for a floating asset: *Vaughan v Archie Parnell and Alfred Zeitlin Ltd* (1940) 23 TC 505.

If a business consists of the making of a number of commercial contracts in the hope of making profits by their performance, any damages that may be recovered as compensation for the breach of one of those contracts is a receipt that must be taken into account for the purpose of arriving at the total profits and ultimately at the net income of the business: *Commissioners of Taxation (NSW) v Meeks* (1915) 19 CLR 568, also *Inland Revenue Commissioners v Fleming & Co (Machinery) Ltd* (1951) 33 TC 57.

If interest is paid as part of a compensation package and the fact that it would be payable was not material to the calculation of the amount of compensation to be paid, it is assessable: *Marshall v Commissioner of Taxes* [1953] NZLR 335 (CA and SC) and *Public Trustee v Commissioner of Inland Revenue* [1960] NZLR 365 (SC).

The taxpayer was retained by a company to assist it on a particular project on the basis he would be appointed to a senior position if it was successful. Although employed for seven years he was never appointed to the senior position. A termination agreement was signed and the loss of office compensation payment was assessable: *Hardy v Commissioner of Inland Revenue* (1986) 8 NZTC 5,035 (HC).

The taxpayer entered a contract to supply Lion Breweries Ltd (“LBL”) with certain products for 10 years. LBL formed a subsidiary to supply its hotels with the goods and an agreement was reached whereby the taxpayer relinquished its contract for a sum of $125,000. A sum of $37,500 was payable in consideration of LBL purchasing the taxpayer’s right of supply of goods other than glassware. In the event of LBL obtaining a glassware franchise, the taxpayer’s right of supply of glassware would terminate in consideration of the sum of $82,500. The High Court held there was no difference in the nature of the payments, the first being a payment for the purchase of the right to supply goods and the other being a compensation for loss. The quantum of each payment was based on the estimated loss of profits for the eight years of the contract to remain. The sum of $37,500 paid was held to be not capital, the taxpayer only losing sales to LBL which for
two years had averaged only a 20 per cent contribution to the company’s profits: *KR Greenslade Ltd v Commissioner of Inland Revenue* (1986) 8 NZTC 5,197 (HC).

A New Zealand manufacturer had entered into a contract with two overseas companies to supply goods worth about $500,000. The overseas buyers later cancelled the contract and the New Zealand company claimed damages for breach of contract. The New Zealand company finally agreed to accept $27,500 in full satisfaction of its claim. Included in this sum was an amount of $20,477 being the value of the tax incentive lost through the breach of contract. The taxpayer company contended that the sum of $20,477 should be exempt because the export incentive allowance was not of an income or revenue nature since taxpayers were not taxed thereon and, accordingly, that compensation paid for the loss of that incentive was not assessable. Inland Revenue, on the other hand, considered that the amount in question constituted profits or gains derived from a business and that the sum constituted income according to ordinary concepts. The TRA held that the sum of $20,477 was of a revenue nature and formed part of the taxable income of the objector company: *TRA Case C7* (1977) 2 TRNZ 231.

Earnings-related accident compensation is assessable in full in the year of receipt, notwithstanding that it may be calculated by reference to loss of earnings over a period longer than a year [s CF 1, see 20.25].

### 200.20 Compensation payments to fill a “hole in capital assets”

Compensation to fill a “hole in the capital assets” is not assessable [s CB 1(2)]. For example, compensation received by shipowners for the loss of a ship which had been negligently run down and sunk by a vessel belonging to another shipowner.

In each of the following cases compensation received has been held to be a capital receipt:

(a) A lump sum received for the cancellation of an agency contract involving the closing down of the business: *Californian Oil Products Ltd (in liq) v Federal Commissioner of Taxation* (1934) 52 CLR 28 (HCA) and *Barr Crombie & Co Ltd v Inland Revenue Commissioners* (1945) 26 TC 406. This should be distinguished from where an agency agreement with only one year to run was cancelled, which was only one of several similar agreements, and the closing down of the business was not involved: *Kelsall Parsons & Co v Commissioner of Inland Revenue* [1938] SC 238, (1938) 21 TC 608.

(b) A sum received by a fireclay company for leaving unworked the fireclay under a railway. The fact that the damages received are measured by reference to the loss of future income is not conclusive as to the revenue nature of the sum received: *Glenboig Union Fireclay Co Ltd v Commissioner of Inland Revenue* [1922] SC 112, (1922) 12 TC 427 (HL).

(c) Damages received on the premature determination of pooling agreements. The agreements formed the fixed framework within which the circulating capital operated; they were not incidental to the working of their profit-making machine, but were essential parts of the mechanism itself: *Van den Berghs Ltd v Clark (Inspector of Taxes)* [1935] AC 431, (1935) 19 TC 390 (HL).

(d) A sum of £1,406 paid by Mobil Oil NZ Ltd, on behalf of a service station proprietor, to improve the design and layout of a new service station. This was held not to be income in the hands of the service station proprietor. The grounds for the judgment were:

(i) The service station proprietor did not bind itself to deal exclusively in Mobil products;

(ii) Had the expenditure been made by the service station proprietor it would not have been deductible for tax purposes; and

(iii) The expenditure, as far as the service station proprietor was concerned, was not a profit or gain made by the profit-making structure but was part of the profit-making structure itself then in the process of being set up, and therefore the gain was a capital gain to the service station proprietor: *City Motor Service Ltd v Commissioner of Inland Revenue* [1968] NZLR 780 (SC).

(e) An extra $250,000 where the sale of a freezing works for $2 million was later increased to $2.25 million. This was done to allow the purchaser the right to market certain stock which it could not
Compensation and Damages

200.30

have done if the original agreement had remained in place. The decision bore in mind the overall activities of both parties and recognised that it was a payment in compensation for a part of the objector’s continuing business. It was not compensation for lost income but a redistribution of capital between the two companies. *Thomas Borthwick & Sons (Australasia) Ltd v Commissioner of Inland Revenue* (1991) 13 NZTC 8,063, (1991) 15 TRNZ 679 (HC). The CIR’S appeal was dismissed: *Commissioner of Inland Revenue v Thomas Borthwick & Sons (Australasia) Ltd* (1992) 14 NZTC 9,101 (1992) 16 TRNZ 777 (CA).

(f) Compensation for libel.

Certain compensation payments are specifically exempt [ss CW 34 and CW 35, see 370.15].

200.30 Compensation payments for damage to vehicles

Some aspects of the assessability of compensation can be difficult to decide especially when income depends on the continued running of an asset like a motor vehicle needed by carriers, couriers, taxi drivers, etc. A distinction can be drawn between compensation for the damage to the asset itself, which can be capital, and compensation for loss of profits which would have been made had the asset not been damaged, which is revenue. Any amount received as compensation whether by way of insurance or damages for income lost due to damage to vehicles is business income and assessable.

Insurance compensation received for damage to a vehicle is further discussed in 250 DEPRECIATION.

200.40 General and special damages

Any general or special damages awarded in a common law action is not generally assessable. It is considered that damages are a capital receipt, even when the award is made for loss of past or prospective earnings consequent on forced incapacity to earn, except for earnings-related accident compensation payments [see 200.10].

A totally different question is whether damages awarded for personal injuries based upon the loss of past or prospective earnings should make any reference to income tax. The question is whether an award of damages for loss of earnings should be merely the amount the injured party would have retained after paying income tax on the earnings which determined the amount of the total loss.

In *British Transport Commission v Gourley* [1955] 3 All ER 796 (HL), the House of Lords held that in an action for personal injury or wrongful dismissal, when assessing damages for the loss of actual or prospective earnings, allowance must be made for any incidence of income tax on the earnings where the damages themselves are not taxable in the hands of the recipient. The injured person’s earnings were much reduced as the result of an accident attributable to the defendant (who was not the employer) and the sum of £37,720 which was awarded in the first instance was later reduced by the House of Lords to £6,695, being the estimated residual sum after income tax and surtax had been paid on it. The body which had to pay the damages was obliged only to pay an amount which would put the injured party in the same position after income tax and surtax.

In the New Zealand case of *Smith v Wellington Woollen Manufacturing Co Ltd* [1956] NZLR 491 (CA), the Court of Appeal followed the House of Lords’ decision in the *British Transport Commission* case, thus overruling the Court of Appeal decision in *Union Steam Ship Co of New Zealand Ltd v Ramstad* [1950] NZLR 716 (CA), to the effect that the fact that the plaintiff would be liable to pay less income tax in the future because of loss of earning capacity should not be taken into account by the jury when assessing damages.

Another New Zealand case, *North Island Wholesale Groceries Ltd v Hewin* (1982) 5 NZTC 61,289 (CA), related to damages that were awarded for wrongful dismissal. In calculating the damages to be paid, the taxation implications were not considered. This basis of calculation was upheld in the Court, so it was decided that the rule in the *British Transport Commission* case should not be extended to claims for loss of office.

For the taxability of compensation payments for humiliation, loss of dignity or injury to feelings under the Employment Relations Act 2000 and the Human Rights Act 1993 [see 1300.60].

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200.50 Deductibility of costs of compensation action [ss DA 1, DA 2(1)]

The costs of either a successful or unsuccessful claim for compensation are deductible for income tax purposes under s DA 1 when the claim is for amounts which would be assessable if recovered. Costs are not deductible if the compensation, if recovered, were a capital receipt [s DA 2(1)].

Compensation is deductible in the year in which the liability arose (ie, was incurred), and not the year in which payment was made. Any legal costs involved are generally deductible when the fee is rendered. However, Inland Revenue is generally prepared to allow the deduction in the year when it is actually paid.

200.60 When compensation payments are not deductible [ss DA 2(1), DC 1]

Compensation paid has been held to be not deductible in the following cases.

In *Royal Insurance Co Ltd v Watson (Surveyor of Taxes)* [1897] AC 1, (1897) 3 TC 500 (HL), an insurance company acquired the business of a similar company. The agreement provided that the manager of the acquired company should be retained but subject to termination of employment on payment of a lump sum. When employment was terminated the lump sum was held to be a part of the cost of acquisition of the business and not deductible. In New Zealand, it is possible for a lump sum payment made by an employer to an employee to qualify as a deduction being a bonus, gratuity, or retiring allowance paid on the occasion of the employee’s “retirement” [s DC 1].

In *Commissioner of Inland Revenue v The Anglo Brewing Co Ltd* (1925) 12 TC 803, a company on closing its business agreed to pay its employees certain sums as annuities or compensation for loss of office. The payments were not made for carrying on the business of the company but to wind it up and were not deductible.

In *Mallett (Inspector of Taxes) v Staveley Coal & Iron Co Ltd* [1928] 2 KB 405, (1928) 13 TC 772, a payment by a colliery company as the price of being allowed to surrender unprofitable seams in its leasehold was held to be capital expenditure, and not deductible.

In *Commissioner of Inland Revenue v McKenzies New Zealand Ltd* (1988) 10 NZTC 5,233 (CA), a payment to the lessor to rescind a lease agreement was not deductible, the Court of Appeal holding that the relevant lease was not part of the company’s trading stock but part of the business profit-making structure. Accordingly, the lump sum paid for surrender of the lease was itself an expenditure of capital and non-deductible.

Further examples of non-deductible compensation are:

(a) Compensation paid as consideration for closing down an opposition business in order to exclude competition. This is a payment to acquire an advantage of an enduring nature and is consequently neither deductible by the person making the payment nor assessable to the recipient. This applies even where the restriction as to the operation of a competitor is for a limited period only. The fact that payments made under an agreement of such a nature are weekly or monthly does not make them deductible, as they are merely instalments of capital.

(b) Compensation paid by a lessee for the cancellation of a lease [see 900 LEASED ASSETS].

(c) An agreement by an employee not to continue trade in opposition to their employer. On the discharge of an employee an agreement was made between the employee and former employer under which the employee covenanted not to divulge trade secrets or working methods learnt during the period of employment and also not to carry on or accept employment in any competing business for a period of five years. The agreement provided that so long as the employee observed these covenants the employer would pay the employee a fixed annual amount, paid in quarterly instalments. The payments were regarded as capital payments made for the protection of the goodwill of the business of the employer and therefore not deductible. Such payments were also regarded as not being assessable to the employee even though they were payable over a period of years.

A payment made under a restraint of trade agreement does not automatically lose its character as capital (as the CIR had contended) merely because the agreement is found by the Court to be invalid under the Illegal Contracts Act 1970: *TRA Case L23* (1989) 11 NZTC 1,147. The nature of the payment must be determined by looking at the intentions of the parties to the agreement. Inland Revenue has indicated that in these...
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circumstances it would apply the general principles expressed in *Buckley & Young Ltd v Commissioner of Inland Revenue* [1978] 2 NZLR 485, (1978) 3 NZTC 61,271 (CA) [see TIB vol 4:7 (March 1993) at 7]. The CIR clarified his policy on the deductibility of restraint of trade payments in TIB vol 6:10 (March 1995) at 2, by stating that a restraint of trade payment is generally a payment on capital account, because it relates to the income-earning structure of the business rather than the income-earning process, and therefore is not deductible to the payer under s DA 2(1). Payments that are capital in the hands of the payer are usually, but not necessarily, capital receipts in the hands of the recipient. The nature of the payment in the hands of the payer and the recipient depends on the particular circumstances in each case.

Restraint of trade agreements (restrictive covenants), are further discussed in 1265 RESTRICTIVE COVENANTS AND EXIT INDUCEMENTS.

200.70 When compensation payments are deductible [s DA 1]

For compensation payments to be deductible they must be incurred in deriving assessable or excluded income, or in carrying on a business for the purpose of deriving assessable or excluded income [s DA 1]. Compensation or damages paid in the following circumstances are deductible:

(a) Compensation paid as a result of the death or injury of an employee, to the extent that the amount paid is not reimbursed by insurance and the damages are not the result of the employer’s negligence.

(b) Damages paid for injury to person or property caused by an employee of a business, in transporting the goods of that business, or in the performance of other duties associated with the business: *Renfrew Town Council v Commissioner of Inland Revenue* (1934) 19 TC 13. Where the claim arises from the acts of the employer the position is not so clear and it requires a decision on the facts of the particular case. Claims have been allowed even where they were based on the personal acts of the employer where it has been shown that those acts were in the ordinary course of business and the claims were inherent risks of the business.

(c) Damages paid as a result of a nuisance caused to neighbours where the nuisance is an ordinary incident in the carrying on of the business, eg damages paid for a nuisance caused by a smoking chimney on the taxpayer’s factory premises.

(d) Damages and costs paid by a newspaper proprietor in an action for libel, irrespective of whether the newspaper proprietor is successful in the action or whether the matter is settled by compromise: *Herald and Weekly Times Ltd v Federal Commissioner of Taxation* (1932) 48 CLR 113 (HCA). No deduction is permitted, however, where a deliberate infringement of the law has given rise to the suit.

(e) Any amount paid to the customer to obtain release from an onerous trade or business contract or to avoid loss in revenue expenditure is deductible: *Commissioner of Inland Revenue v Northfleet Coal & Ballast Co Ltd* (1927) 12 TC 1102.

(f) An amount paid by a company to terminate connections with a life director, whose presence on the board was regarded as detrimental to the profitable conduct of the company’s business: *Mitchell v BW Noble Ltd* [1927] 1 KB 719, (1927) 11 TC 372.

(g) Compensation payments by a farmer for working dogs worrying sheep are deductible, but not when the dogs are kept for sporting purposes or home pets.
Chapter 215
Conduit Tax Relief

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215.10 Relief from conduit taxation [ss LQ 1, LQ 2, LQ 3, LQ 4, LQ 5, RG 7, YD 9, YD 10, YD 11]

(1) Repeal of conduit rules

With the changes to the controlled foreign company rules in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 the conduit tax relief rules have been consequentially repealed for income years beginning on or after 1 July 2009. However, parts of the rules have been retained for a period of two years.

Under the new rules, no further conduit tax relief will arise under the conduit mechanism. Section OD 23 has been repealed to remove the tax liability that can arise from CTR debits. In other words, CTR credits will cease to be a contingent liability. An exception to this is if the anti-avoidance rule in s GZ 2 is found to apply.
Conduit Tax Relief

Section GZ 2 is intended to claw back conduit tax relief from arrangements that were entered into in anticipation of the repeal of s OD 23 that had the effect of reducing the tax liabilities of New Zealand shareholders. Section GZ 2 applies to arrangements that generated conduit tax relief credits between 4 December 2008 (when an issues paper announcing this policy was released) and the date from which conduit tax relief was repealed. Section GZ 2 does not apply to conduit tax relief received by the conduit tax relief company itself, or by a CTR holding company for the CTR company.

CTR companies will be able to continue to attach CTR credits to any dividends they distribute to their non-resident shareholders, for a period of two years. This provides time for conduit-relieved income (represented by CTR credits) to be channelled to non-residents and any CFC income on which New Zealand tax has been paid (represented by FDP credits) to be channelled to New Zealand residents.

CTR companies that do not wish to distribute their foreign income in this way, can, under the new rules, elect to cease to be a CTR company under s OD 4 and have their CTR credits extinguished with no liability. Section OD 4(3) has been amended to make it so this election will take effect from the day after the election was made as this allows companies to convert FDP credits into imputation credits (under the previous rules, these companies would have had to wait until the next tax year before the election took effect).

Another option is for CTR companies to simply retain their CTR credits for the two-year transitional period, after which these credits will be extinguished with no tax liability. Inland Revenue advise that the legislation for this final repeal of CTR accounts will be introduced as part of a subsequent tax Bill.

(2) Previous rules

The term “conduit investment” refers to investment by a non-resident into a foreign company that is made through an intermediary company resident in a third country. The term “conduit taxation” refers to taxation of foreign income derived by a resident company on behalf of its non-resident shareholders. “Conduit tax relief” (CTR) is available in such situations.

In New Zealand, conduit taxation occurs because the “controlled foreign company” (CFC) and foreign investment fund (FIF) rules attribute income of foreign entities back to its New Zealand owner, notwithstanding that the New Zealand owner may be a company with non-resident shareholders. In this situation conduit taxation will occur to the extent that the New Zealand company is taxed on its foreign-sourced income on behalf of its non-resident shareholders.

Relief from conduit taxation is provided as follows:

(a) The New Zealand company’s income tax liability is reduced to the extent that it is owned by non-resident shareholders, in respect of foreign attributed income (attributed foreign income from CFCs and FIF income calculated under the accounting profits and branch equivalent methods) and foreign dividend payment (FDP) liabilities on foreign-sourced dividends [see 215.15 and 215.20].

(b) Special rules treat “conduit tax relief” (CTR) holding companies and other members of 100 per cent chains of companies as non-resident for the purpose of determining the amount of CTR to which a company is entitled [see 215.25].

(c) Interest allocation rules reduce the amount of CTR to which a company is entitled if the group of companies to which the company belongs has excessively geared its New Zealand operations relative to its non-grey-list CFC and FIF interests [see 215.95].

(d) The amount of CTR is credited to the “conduit tax relief account” (CTRA). The CTRA ensures that the CTR is passed on to the company’s non-resident shareholders [see 215.40].

(e) Tax paid on foreign attributed income and FDP paid on foreign-sourced dividends is credited to the FDP account [see 670.155].

(f) FDP account credits are attached to dividends paid to resident shareholders while CTR credits are attached to dividends paid to non-resident shareholders [see 215.65].

(g) Allocation and anti-avoidance rules apply to maintain the integrity of the existing anti-streaming rules [see 215.75].
Where CTR credits are attached to dividends paid to non-resident shareholders, the company passes on the benefits of the CTR by paying non-resident shareholders an additional dividend [see 215.30].

In other words, subject to the interest allocation rules, the regime relieves New Zealand resident companies from tax under the CFC and FIF rules to the extent that the company is owned by non-resident shareholders. The amount of CTR is credited to the CTRA. When conduit income is distributed to non-resident shareholders, the CTR received by the company is also passed on to the non-resident shareholders in the form of an additional dividend. New Zealand tax on dividends that carry full CTR credits is limited to non-resident withholding tax (NRWT) at the rate of 15 per cent.

### 215.15 Calculating relief from income tax [ss LQ 1, LQ 2]

A CTR company is entitled to a rebate of income tax (CTR) for any tax year corresponding with a tax year for which the company is a CTR company, provided the company is still a CTR company at the time it files its income tax return for that year.

The amount of CTR on foreign attributed income (attributed foreign income from CFCs and FIF income calculated under the accounting profits and branch equivalent methods) is calculated in accordance with the following formula:

\[
\text{percentage of shareholders} \times (\text{tax rate} \times (\text{company's income} - \text{company's losses} - \text{excess interest allocation}) - \text{company's credits} - \text{amounts credited})
\]

Where:

- “Percentage of shareholders” is the percentage of company shareholders who are non-resident,
- “Tax rate” is the basic rate of income tax for companies, expressed as a percentage, for the income year (currently 30 per cent),
- “Company’s income” is the company’s foreign attributed income for the tax year,
- “Company’s losses” is the company’s foreign attributed loss offsets for the tax year,
- “Excess interest allocation” is the excess interest allocation, if any, for the tax year calculated under s FF 6 [see 215.125],
- “Company’s credits” is all tax credits that would be allowed against the company’s income tax liability for the tax year under subpart LK that could be used to satisfy the company’s income tax liability for the tax year,
- “Amounts credited” is the total of:
  - The amount of “branch equivalent tax account” (BETA) debits available to be credited against the company’s income tax liability for the tax year; and
  - The amount of BETA debits credited by another company in the same group against the company’s income tax liability for the tax year (in both cases calculated as if no CTR was available under s LQ 2).

The above formula is more easily understood if it is broken down into its components:

- First, tax is determined on the company’s foreign attributed income less any foreign attributed losses offset against that income and the amount of any interest expense allocated against the company’s foreign attributed income (eg the part of the formula comprising: “tax rate × (foreign attributed income – foreign attributed loss – excess interest allocation”).
- Secondly, the amount of tax is reduced by any credit for tax paid by a CFC or FIF under the branch equivalent method, and by any offset of available BETA debits (eg the part of the formula comprising: “all tax credits that would be allowed against the company’s income tax liability – the total of amounts credited”).
- Finally, the net amount of tax is reduced by the percentage of resident shareholders in the company (eg the part of the formula comprising: “percentage of shareholders”).
Two points should be noted in respect of the above formula. First, the term “foreign attributed loss offsets” is defined in s YA 1 to include only attributed foreign losses from CFCs and FIF losses calculated under the branch equivalent or account profits methods. Secondly, the CTR calculated under the formula cannot be less than nil or more than the company’s net tax liability attributable to non-resident shareholders.

**215.20 Calculating relief from foreign dividend payments [s RG 7]**

Section RG 7 provides for CTR on foreign-sourced dividends subject to FDP. Companies that are CTR companies at the time they are required to pay a FDP may reduce the FDP by the following amount:

\[ \text{percentage of non-resident shareholders} \times \text{amount of FDP} \]

Where:

“Percentage of non-resident shareholders” is the percentage of non-resident shareholders of the company; and

“FDP” that would otherwise have to be deducted and paid to the CIR (after any loss offsets claimed under s 32M of the TAA).

Four points should be noted in respect of the above formula.

(a) The formula includes special rules for calculating the percentage of non-resident shareholders, including rules specifying the time at which the calculation is made.

(b) In determining the amount of FDP that would otherwise have to be deducted, allowances need to be made for “underlying foreign tax credits” (UFTCs), foreign withholding taxes, loss offsets, and branch equivalent tax account (BETA) offsets.

(c) The interest allocation rules in subpart FF do not apply in determining the amount of relief when the FDP is paid.

(d) When the interest allocation calculations are performed for the relevant tax year, and the excess interest allocation exceeds the group’s net foreign attributed income for the year, the balance will be allocated against FDP relief under s FF 7 [see 215.130].

**215.25 Calculating the percentage of non-resident shareholders [ss CW 10, FE 29, LQ 3, LQ 4, YD 9, YD 10, YD 11]**

Section LQ 3 comprises the rules for determining what percentage of a company’s shareholders are non-resident for the purposes of calculating CTR. Section LQ 3(2) provides that the percentage of shareholders in a CTR company that are non-resident is the lowest of the percentage of direct voting or market value interests (if a direct market value circumstance exists) held by those non-resident resident shareholders, and the percentage of dividends that would be derived by non-resident shareholders if the company were liquidated.

To minimise compliance costs, the applicable time to determine the percentage of shareholders that are non-resident is calculated on the last day on which the company paid a dividend to all shareholders during the tax year.

**Note**: Companies are already required to determine which shareholders are non-resident when paying dividends in order to determine whether to withhold resident withholding tax (RWT) or non-resident withholding tax (NRWT) from the dividend. If the company has not paid a dividend to all shareholders during the tax year, the calculation is made at the end of the tax year. Special rules apply for determining the date on which the calculation is made for companies with more than one class of share.

A listed company may use either:

(a) The record date (the date on which shareholders’ entitlements to dividends are determined) for a dividend instead of the date on which the dividend is paid; or

(b) Any date in the tax year on which the company, for whatever commercial reason, calculates the percentage of non-resident shareholders.

Treasury stock is excluded from the calculation.
Conduit Tax Relief

If a company is a 100 per cent subsidiary of a CTR company, it will use the same measurement date as that determined for the parent.

Special rules treat CTR holding companies and other members of 100 per cent chains of companies (CTR group members) as non-resident for the purposes of the CTR rules. In essence, these rules allow CTR to arise where a non-resident investor holds its New Zealand interests through a holding company structure. These rules [ss YD 9 to YD 11] can be summarised as follows:

(a) A CTR company that is wholly owned by a single non-resident shareholder (other than a CFC or trustee of a non-qualifying trust) can elect to become a CTR holding company.

Note: Nominee shareholders who exist to meet company law requirements are disregarded.

(b) A CTR holding company is treated as non-resident for the purposes of calculating the entitlement to CTR of New Zealand companies in which it holds a direct interest of at least 10 per cent, provided it notifies the New Zealand company that it is a CTR holding company.

(c) A CTR company that wholly owns another CTR company is treated as a CTR group member if a non-resident shareholder holds a direct interest in the CTR group member, or in another New Zealand resident company in the same wholly-owned group of companies which has a 100 per cent interest in the CTR company (disregarding nominee shareholders who exist to meet company law requirements).

Note: A non-resident is deemed to be resident in New Zealand for the purpose of determining whether or not a CTR company is a CTR group member in respect of another CTR company, where that person is associated with either CTR company, and is either a CFC or a trustee of a non-qualifying trust.

(d) A non-resident shareholder is deemed to be resident in New Zealand for the purposes of calculating CTR if it is associated with a CTR company and is either a CFC or a trustee of a non-qualifying trust.

(e) A CTR group company is treated as non-resident for the purposes of calculating the entitlement to CTR of a CTR company, to the extent that the CTR group company is ultimately owned by a non-resident shareholder.

(f) Dividends paid up the 100 per cent chain are exempt from tax [s CW 10]. Dividends paid to CTR holding companies are exempt from tax to the extent to which full CTR credits are attached [s CW 11].

(g) If the CTR holding company's direct interest in another New Zealand company with which it has elected to be a CTR holding company falls below 10 per cent, the CTR holding company will no longer be treated as a non-resident shareholder of that company. Accordingly, the special rules concerning the calculation of CTR and the tax exempt status of dividends with CTR credits attached will no longer apply to that New Zealand company. Note that there is no provision for a claw-back of CTR credits.

(h) If the shares in the CTR holding company are sold to another person other than another single non-resident person, a breach of continuity will be deemed to have occurred and the CTR holding company will be required to pay the CIR an amount equal to any credit in its CTRA at the time that the breach of continuity occurred [see 215.60].

(i) The CTR holding company cannot elect to apply the 66 per cent grouping option under the thin capitalisation rules in respect of any company with which it is treated as a non-resident shareholder, unless the CTR holding company on-pays all dividends it receives with CTR credits attached to its non-resident shareholder in the year in which it receives the dividends [s FE 29, see 1000.110].

215.30 Additional dividends paid to non-resident shareholders [s LQ 5]

Where a CTR company attaches a CTR credit to a dividend paid to a non-resident shareholder, the company is required to pay an additional dividend to the non-resident shareholder equal to the amount of the CTR credit. The additional dividend mechanism ensures that the CTR received by the CTR company is passed on to its non-resident shareholders.
Section LQ 5 introduces the following rules to ensure that the additional dividend mechanism does not contravene credit allocation rules or company law and trust deed requirements:

(a) The payment of additional dividends is ignored when applying the allocation rules in s OA 18 (as modified by ss OD 20 to OD 21) and the anti-avoidance rule in ss GB 35 to GB 36 (as modified by s OD 18);

(b) The payment of additional dividends will not breach company law or the company’s constitution; and

(c) A trustee deriving an additional dividend on behalf of a non-resident beneficiary can distribute that dividend to the non-resident beneficiary without breaching the terms of the trust.

These rules are similar to the rules that apply in respect of supplementary dividends under the FITC regime [see 1010.45].

215.35 Example of conduit tax relief

The following example from TIB vol 10:4 (April 1998) at 4 demonstrates how the CTR mechanism operates. In particular, it illustrates:

(a) How CTR is calculated;
(b) How the CTR and FDP accounts operate; and
(c) How conduit income is distributed.

Note that the example does not consider some of the more difficult aspects of the CTR mechanism, such as the effect of interest allocation rules, changes in shareholding between the time income is derived and distributed, foreign tax credits, and branch equivalent tax account (BETA) offsets.

**Example:**

Resident and non-resident shareholders each own 50 per cent of a New Zealand company (NZCO). NZCO earns $200 of attributed income from a CFC or FIF on which no foreign tax is paid.

Ordinarily, NZCO would have paid $60 ($200 × 30%) of New Zealand income tax in respect of this income, which would have given rise to a credit of $66 in NZCO’s imputation credit account (ICA).

Under the CTR mechanism, NZCO is relieved of 50 per cent of the tax on the CFC or FIF income, based on NZCO being 50 per cent owned by non-resident shareholders. The net New Zealand income tax of $30 is credited to NZCO’s FDP account (instead of its ICA), while the $30 of tax relieved is credited to the CTRA.

NZCO distributes the income to its shareholders as follows:

<table>
<thead>
<tr>
<th>Non-resident shareholders</th>
<th>Resident shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash dividend</td>
<td>$70</td>
</tr>
<tr>
<td>Additional dividend</td>
<td>$30</td>
</tr>
<tr>
<td>NRWT</td>
<td>($15)</td>
</tr>
<tr>
<td>Net dividend</td>
<td>$85</td>
</tr>
</tbody>
</table>

The first point to note is that the FDP credits are allocated to the resident shareholders, while the CTR credits are allocated to the non-resident shareholders. This is appropriate, as the tax has been paid on behalf of the resident shareholders (giving rise to FDP credits), whereas the relief has been provided for the non-resident shareholders (giving rise to CTR credits).

The second point is that the CTR credits attached to the dividends paid to the non-resident shareholders give rise to a requirement for the company to pay an additional dividend to those shareholders of the amount of the credits. This is to ensure that the benefits of the conduit relief are passed on to non-resident shareholders. The effect is that a cash dividend of $70 is paid to the resident shareholders, while $100 is paid to the non-resident shareholders. However, both resident and non-resident shareholders are liable for tax on $100 of dividend. The FDP credit forms part of the taxable dividend of the resident shareholders.

Following the imposition of tax on dividends, the net effect is that the $100 of foreign income attributable to the resident shareholders has been taxed at 30 per cent, while the $100 attributable to the non-resident shareholders has been taxed at 15 per cent (the rate of NRWT).
Conduit Tax Relief

215.40 Conduit tax relief accounts [s OD 1]
A foreign dividend payment account (FDPA) company may choose to become a CTR company [see 215.45]. The purpose of the CTRA is to ensure that the CTR is passed on to the company’s non-resident shareholders. As such, it must maintain a CTRA for a tax year. The account is a record of CTR credits and CTR debits that arise in the account during the tax year.

Credits to the account include the amount of a tax credit calculated under section LQ 1 or LQ 2 (which relate to tax credits for conduit tax relief) for the income tax imposed on foreign attributed income and the proportion that non-resident shareholders have to total shareholders. Section RG 7 applies to reduce the amount of FDP payable for a foreign dividend.

Debits to the account include the amount of a CTR credit attached to a dividend paid to the company’s non-resident shareholders. A consolidated group must maintain a group CTRA if a group company is a CTR company.

The carrying forward of a credit in the company’s CTRA is subject to the resident shareholder continuity requirements of s OD 16. Section OZ 17 (CTRA reductions) may apply to modify the credits and debits arising under this subpart.

215.45 Election to maintain a CTR account [ss OD 1, OD 2, OD 4]
A FDP account company may elect to maintain a CTRA and become a CTR company. A company must notify the CIR of its election to become a CTR company. The election is generally effective from the start of the tax year, except for the purposes of attaching FDP or CTR credits to dividends paid to non-resident shareholders. In the latter case, the election is effective from the date of notification. This is because it would be impractical to allow the election to be backdated.

A CTR company must maintain its CTRA from the beginning of the tax year and for every subsequent tax year until the end of the tax year in which it revokes its election. Revocation will not be effective until the company files its final annual imputation return and pays any FDP which is payable as result of the revocation under s OD 23 [see 215.80]. Revocation is effective from the beginning of the imputation year following that in which the revocation is made. A company is treated as having revoked its election if it elects to cease to be a FDP company.

A company that ceases to be a FDP account company as a result of emigrating [s OC 5, see 670.145]:
(a) Ceases to be a CTR company;
(b) Must furnish an annual imputation return for the tax year in which the company becomes non-resident by the date specified in s 69 of the TAA [see 670.65]; and
(c) Must pay any FDP payable under s OD 23 as a FDP account company for the tax year.

If a company does not elect to maintain a CTRA, its shareholders will still be entitled to conduit relief when foreign attributed income is distributed, provided that the company elects to maintain a FDP account. Relief is by way of a refund of FDP credits in excess of the non-resident shareholders’ non-resident withholding tax (NRWT) liabilities [see 670.185]. Note that the interest allocation rules will still apply in determining the amount of foreign attributed income subject to relief [see 215.95].

215.50 Information to be recorded in the CTR account [ss OA 2, OA 3, OA 7]
A CTR company must record in its CTRA the opening balance for the imputation year and any credits and debits arising [see 215.36 and 215.38]. The opening balance of the CTRA for a tax year will be the closing balance for the previous tax year. For the first tax year in which the company elects to become a CTR company, the opening balance of the CTRA will be nil. A tax year is a year ending on 31 March.

215.55 Credits to the CTR account [ss OD 5, OD 6, OD 7, OD 8, OD 9]
The following amounts are recorded as credits in the CTRA:
(a) The amount of CTR allowed under ss LQ 1 and LQ 2 [see 215.12]. The credit arises on the last day of the tax year corresponding with the tax year, to the extent that the provisional tax payments have
been made for the year on or before that date. To the extent that provisional tax payments have not been made on or before the last day of the tax year, the credit arises on the date the company files its annual tax return;

(b) The amount of any credit transferred from the company’s FDP account [see 215.80]. This credit arises immediately before the end of the tax year;

(c) The amount of CTR credits attached to dividends received by the company from a lower-tier group company. This credit arises on the date that the dividend is paid;

(d) The amount by which FDP is reduced under s RG 7 for dividends paid to the company during the tax year [see 215.20]. This credit arises on the date that the company is required to pay the reduced FDP to the CIR;

(e) The amount of any debit recorded in respect of an arrangement to obtain a tax advantage which has subsequently been reversed. This credit arises on the date that the debit initially arose.

215.60 Debits to the CTR account [ss OD 10, OD 11, OD 12, OD 13, OD 14, OD 15, OD 16, OD 17, OD 18, OD 19]

The following amounts are recorded as debits in the CTRA:

(a) The amount of any CTR credit attached to a dividend paid by the company during the tax year. This debit arises on the date the dividend is paid.

(b) The amount of any credit transferred from the CTRA to the FDP account [see 215.80]. This debit arises immediately before the end of the tax year.

(c) The amount of a credit transferred to the CTRA of a consolidated group under s OP 84. The debit arises on the date of transfer.

(d) The amount of any further FDP payable under s FF 7(8) [see 215.130]. This debit arises on the date on which the income tax return for the year for which the adjustment is made is filed.

(e) The amount of any credit in the CTRA (that has not been previously cancelled by a debit) for CTR or a reduction in FDP that would not have arisen except for the application of the holding company rules in ss YD 9 to YD 11, and those rules no longer apply. In other words, a debit will arise if the shares in a CTR holding company have been sold to other than a single non-resident person [see 215.25]. This debit arises when the holding company rules cease to apply.

(f) The amount of any credit in the CTRA under s OD 7 (that has not been previously been cancelled by a debit) that arose from dividends received from a lower-tier group company, and that company ceases to be a CTR group member. This debit arises when the company also ceases to be a CTR group member.

(g) The amount of any credit in the CTRA (that has not previously been cancelled by a debit) if the percentage of New Zealand resident shareholders of the company has increased by at least 34 per cent since the time that the credit arose. This debit arises at the time the New Zealand resident shareholding of the company increases by least 34 per cent.

(h) The amount of any allocation deficit that arises under s OA 18(2) as a result of excessive CTR credits being attached to a dividend [see 215.75]. This debit arises at the end of the tax year in which the debit arises.

(i) The amount of any debit arising from a credit streaming arrangement that contravenes ss GB 35 to GB 36 [see 215.75]. This debit arises at the end of the tax year in which the arrangement commenced.

(j) The amount of any credit in the CTRA if the company ceases to be a CTR company during the tax year. This debit arises immediately before the company ceases to be a CTR company.

Where a debit arises under items (g), (h), or (i) above, the company will be required to repay the CIR the amount of that debit by the 20th day of the month following the quarter in which the debit arises [s OD 23]. This payment is treated as a payment of FDP, but does not give rise to a credit in the company’s FDP account.
The object of these provisions is to place the company in the same position as if it had been a FDP account company rather than a CTR company. Put simply, if the company had been a FDP account company, the actions giving rise to a debit under items (g), (h), and (i) above, would also have given rise to a debit under the FDP account rules [see 670.160].

Where a debit arises under items (e), (f), or (j) above, the company will also be required to repay the CIR the amount of that debit by the 20th day of the month following the quarter in which the debit arises [s OD 23]. This payment is treated as a payment of FDP and will give rise to a credit in the company’s FDP account. The rationale is that if the company has not elected to be a CTR company, the payment of FDP on foreign attributed income would have given rise to a credit in its FDP account. This FDP credit would not have been affected by the actions giving rise to a debit under items (e), (f), and (j) above.

Three details should be noted in respect of the continuity test in item (g) above:

(1) The percentage of New Zealand resident shareholders is calculated as the highest of:
   (i) The percentage of direct voting or market value interests (if a direct market value circumstance exists) held by New Zealand resident shareholders; and
   (ii) The percentage of dividends that would be derived by New Zealand resident shareholders if the company was liquidated.

(2) Item (g) above, will not apply if the increase in the percentage of New Zealand resident shareholders is solely attributable to a conduit relief holding company ceasing to be non-resident by reason that it no longer holds a 10 per cent interest in a CTR company.

(3) Section OA 8 contains a specific anti-avoidance provision directed at arrangements manipulating the ownership of shares that have a purpose or effect of defeating the intent and application of item (g) above [s OD 16].

215.65 Attaching CTR credits to dividends [ss OD 20, OD 21, OD 22]
CTR companies may attach CTR credits to dividends paid to non-resident shareholders and FDP credits to resident shareholders. CTR companies are not permitted to attach CTR credits to resident shareholders or FDP credits to non-resident shareholders. However, CTR companies may still attach imputation credits to dividends in addition to FDP or CTR credits, subject to the credit allocation rules in ss OD 20 to OD 22 [see 215.75 and 670.175].

215.70 Administrative requirements [TAA, ss 29(1), 30A, 68A, 69(1)(ea), 69(4)]
When a CTR company attaches a CTR credit to a dividend paid to a non-resident shareholder, it must provide the shareholder with a dividend statement detailing the amount of the CTR credit and the amount of the additional dividend [TAA, ss 29(1), 30A].

When a CTR company attaches a CTR credit to a dividend, it must include the following information in its company dividend statement [TAA, s 68A]:
(a) The additional dividend paid to the non-resident shareholder under s LQ 5;
(b) The FDP ratio (calculated as if the CTR credit were a FDP credit); and
(c) The combined imputation and FDP ratio (calculated as if the CTR credit were a FDP credit), if an imputation credit has been attached to the dividend.

A CTR company is required to include the following particulars relating to its CTRA in its annual imputation return [TAA, s 69(1)(ea)]:
(a) The opening and closing balances of the CTRA for the imputation year; and
(b) The amount and source of all credits and debits that have arisen in the CTRA during the tax year.
215.75  **Allocation and anti-avoidance rules** [ss OD 18, OD 19, OD 20, OD 21, OD 22]

The credit allocation rules that apply to FDP credits in ss OC 27 to OC 29 also apply to CTR credits. See 670.175.

The anti-avoidance rules in ss GB 34 to GB 38 that apply to imputation credits and FDP credits also apply to CTR credits [see 670.110]. For the purpose of these rules, the CTR credits are deemed to be FDP credits.

215.80  **Transfers between CTR and FDP accounts** [ss OC 19, OD 11, OD 23, OD 25]

Notwithstanding that the percentage of non-resident shareholders of a CTR company may change between the time the company receives CTR and the time it distributes that relief to non-resident shareholders, the company may only attach FDP credits to dividends paid to resident shareholders and CTR credits to dividends paid to non-resident shareholders. Section OC 19 provides for transfers to be made between the CTRA and the FDP account where either account has a debit balance at the end of the tax year as a result of the requirement to attach FDP credits to resident shareholders and CTR credits to non-resident shareholders.

If the CTRA has a debit balance and the FDP account has a credit balance at the end of the tax year (which generally indicates that the percentage of non-resident shareholders of the company has increased between the time CTR was provided and the time it was distributed). The transfer is to be made from the FDP account to the CTRA for the lesser of the amount of the debit or the credit. Where a credit balance is transferred from a company’s FDP account to its CTRA, the CIR will refund to the company an amount equal to the transfer made, or apply that refund against an outstanding obligation that the company has to the CIR [s OD 25].

If the CTRA has a credit balance and the FDP account has a debit balance at the end of the tax year (which generally indicates that the percentage of non-resident shareholders of the company has decreased between the time CTR was provided and the time it was distributed), s OD 11 requires a transfer to be made from the CTRA to the FDP account for the lesser of the amount of the debit or the credit. Where a credit balance is transferred from a company’s CTRA to its FDP account, the company will be required to make a FDP payment to the CIR equal to the transfer made. This payment must be made by 20 June following the tax year in which the transfer was made [s OD 23].

**Note:** CTR companies are no longer allowed to make transfers from the FDP account to the imputation credit account (ICA) [see 670.165].

215.85  **Other points relating to CTR accounts** [ss OA 2(5), OA 9, OA 10, OB 24, OB 53; TAA, s 104B]

Section OA 2(5) provides a mechanism for the CIR to correct credits and debits incorrectly recorded in the CTRA, unless the company successfully challenges the CIR’s determination that the CTRA is incorrect.

Section OA 12 deals with the consequences of amalgamation where the amalgamating companies maintain CTRAs. If the amalgamated company is not a CTR company, the credit and debit entries of the amalgamating companies’ CTRAs at the date of amalgamation is transferred to the amalgamated company’s “imputation credit account” (ICA). The amalgamated company will then be required to pay the CIR an amount of FDP equal to the amount of any credits transferred. This payment will not give rise to a credit in either the ICA or the FDP account of the amalgamated company. If the amalgamated company is a CTR company, the credit and debit entries of the amalgamating companies’ CTRAs are transferred to the amalgamated company’s CTRA. The continuity of shareholding test will apply from the date credits arose in the CTRAs of the amalgamating companies until the date the credits are distributed, as if the amalgamation had not occurred.

215.90  **Consolidated groups** [ss OP 78 to OP 116]

From 1 April 1998, consolidated groups have been integrated into the conduit taxation rules, enabling them to maintain CTRAs [see TIB vol 11:9 (October 1999) at 5-6]. A consolidated group is required to maintain a group CTRA for a tax year if any company which is a member of the consolidated group is a CTR company [see 215.45] at any time during the tax year. A group CTRA is a separate account from the CTRA of each...
company in the consolidated group [s OP 78]. The opening balance of the CTRA is nil in the first tax year and, for subsequent years, the closing balance at the end of the preceding tax year [s OA 7].

Every company in a consolidated group is a CTR company, whether or not it has elected to be so, if the consolidated group is required (under s OP 1) to maintain a CTRA for an imputation year [s OP 78].

(1) Credits to group CTR account [ss OP 81 to OP 86]

A group CTRA is credited with various amounts on the relevant dates as set out in Table O23 (located after s OP 96). The following details are relevant to the transactions:

<table>
<thead>
<tr>
<th>Credit</th>
<th>Time credit arises</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening credit balance [s OA 7]</td>
<td>1 April.</td>
</tr>
<tr>
<td>Tax credit for conduit tax relief [s OP 81]</td>
<td>See s OP 81.</td>
</tr>
<tr>
<td>Reduction of FDP for dividend derived [s OP 82]</td>
<td>Due date for payment of FDP.</td>
</tr>
<tr>
<td>CTR attached to dividend derived [s OP 83]</td>
<td>Day on which dividend is paid.</td>
</tr>
<tr>
<td>Credit from company’s CTRA [s OP 84]</td>
<td>See s OP 84.</td>
</tr>
<tr>
<td>Transfer from groups FDP account [s OP 85]</td>
<td>31 March.</td>
</tr>
<tr>
<td>Reversal of debit for tax advantage arrangement [s OP 86]</td>
<td>Debit date.</td>
</tr>
</tbody>
</table>

(2) Debits to group CTR account

A group CTRA is debited with various amounts on the relevant dates as set out in Table O24 which is located after s OP 96 in the legislation. The following details are relevant to the transactions:

<table>
<thead>
<tr>
<th>Debit</th>
<th>Time debit arises</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening debit balance [s OA 7]</td>
<td>1 April.</td>
</tr>
<tr>
<td>CTR credit attached to dividend paid by a group company [s OP 87]</td>
<td>Day on which dividend is paid.</td>
</tr>
<tr>
<td>Transfer of a closing credit balance to groups FDP account [s OP 88]</td>
<td>31 March.</td>
</tr>
<tr>
<td>Adjustment for conduit tax relief [s OP 89]</td>
<td>Day on which return of income with adjustment is filed.</td>
</tr>
<tr>
<td>Debit that would increase debit balance for a group company [s OP 90]</td>
<td>Company’s debit date.</td>
</tr>
<tr>
<td>Increase in resident shareholding by more than 34 per cent [s OP 91]</td>
<td>Day of shareholding change.</td>
</tr>
<tr>
<td>Debit for breach of CTR ratio [s OP 92]</td>
<td>31 March.</td>
</tr>
<tr>
<td>Debit for tax advantage arrangement [s OP 93]</td>
<td>Last day of tax year in which arrangement is made.</td>
</tr>
<tr>
<td>Credit balance when group is no longer required to maintain CTR account [s OP 94]</td>
<td>Day on which account stops.</td>
</tr>
</tbody>
</table>

Note: In determining whether a credit has been cancelled by a subsequent debit:

(a) Section OA 7 does not apply;
(b) A credit arising under s OP 84(2) is treated as arising on the date the corresponding credit arose in the CTRA of the group member;
(c) An amount of debit can cancel out a credit only once; and
(d) Debit are offset against credits in the order in which they arise.
A debit arises under s OP 91 if it would have arisen but for an arrangement that affects the shares of the company in the consolidated group, if it had a purpose or effect to defeat the intent and application of these provisions.

(3) Debiting and crediting between group and individual CTR accounts

If a credit arises to a consolidated group’s CTRA for an amount of CTR arising under s LQ 1 [see 215.12] or s RG 7 [see 215.14], or for a CTR credit attached to a dividend received, the same amount may not be credited to an individual company’s CTRA. Similarly, a debit cannot be posted to an individual company’s CTRA if a debit arises to a consolidated group’s CTRA for:

(a) The amount of CTR credit attached to a dividend paid;
(b) The amount of any CTR credit or tax credit refunded;
(c) Any amount of CTR adjustment calculated under s FF 7; or
(d) Any allocation debit arising under s s OA 18.

If a company is a member of a consolidated group at the time it has a credit in its individual CTRA, the credit must be transferred to the consolidated group’s CTRA to the extent that:

(a) A debit arises under ss OA 2 and OA 3;
(b) That debit is not offset [under s OA 8] against a credit in the consolidated group’s CTRA which arose on or before the date the company credit arose; and
(c) The credit does not exceed the consolidated group’s credit.

If credit amounts in the individual CTRAs of two or more members of a consolidated group would be required to be transferred to the group’s CTRA as above, those amounts must be transferred to the group account and credited:

(a) So far as the relevant debit to the group’s CTRA extends and no further;
(b) In the order in which the credits arose as determined by s OA 8; and
(c) If two or more credits arose at the same time, they are credited in the order elected by the consolidated group or, if no election is made, on a pro rata basis.

If a debit, which would create or increase the debit balance in an individual company’s CTRA arises, that debit is posted to the consolidated group’s CTRA, not the individual company’s CTRA.

(4) Transfer to or from FDP account [ss OP 61, OP 70]

If at the end of the tax year the consolidated group’s FDP account is in credit and its group CTRA is in debit, the consolidated group must:

(a) Apply s OP 84 as if the debit balance were the debit referred to in s OP 84; and
(b) To the extent that any debit balance remains, transfer from the FDP account to the CTRA the lesser of:

(i) The credit balance in the FDP account; and
(ii) The debit balance remaining in the CTRA after item (a) above has been applied.

If at the end of the tax year the consolidated group’s FDP account is in debit and its group CTRA is in credit, the consolidated group must transfer the lesser of the two balances from the CTRA to the FDP account.

(5) FDP payable in respect of group CTR account debits [s OP 95]

If a debit arises to a consolidated group’s CTRA under ss OP 91, OP 92, and OP 93, the group must pay to Inland Revenue an amount of FDP equal to the debit by the 20th of the month following the end of the quarter in which the debit arises. The amount of the payment cannot be credited to the group’s FDP account.

If a debit arises to a consolidated group’s CTRA under s OP 94, the group must pay to Inland Revenue an amount of FDP equal to the debit by the 20th of the month following the end of the quarter in which the debit arises.
If a credit balance is transferred from a consolidated group’s CTRA to its FDP account under ss OP 61 and OP 88, the group must pay to Inland Revenue an amount of FDP equal to the amount transferred by 20 June after the tax year in which the transfer was made.

(6) Application of specific CTR account provisions to consolidated groups

Sections OP 80 and OP 96 contain a number of rules about how specific CTRA provisions apply to consolidated groups. Refer to the section for details.

215.95 Conduit groups — interest allocation rules [ss FF 1 to FF 11]

Subpart FF comprises interest allocation rules which prevent companies from maximising CTR by allocating an excessive amount of interest expense to their New Zealand operations, relative to CFCs and FIFs in which they hold interests. Where the interest allocation rules determine that the company’s foreign attributed income group has excessively geared its New Zealand operations relative to its non-grey-list CFC and FIF interests, the excess interest will be reallocated against conduit income, resulting in a reduction in the amount of conduit relief to which the members of that group will be entitled.

Section FF 2 provides that the interest allocation rules potentially apply to both CTR companies and to companies that have not elected to be CTR companies, but nonetheless are entitled to repatriation-based CTR by electing to maintain FDP accounts. It sets out the safe harbour rules for determining whether the interest allocation rules apply.

Section FF 8 contains the rules for determining a company’s foreign attributed income group and s FF 9 provides the rules for calculating the debt percentage for the New Zealand foreign attributed income group. Where the debt percentage for that group exceeds the safe harbour debt percentage, that company may apply the rules in s FF 10 to calculate the debt percentage for the consolidated foreign attributed income group. Where the debt percentage for the consolidated foreign attributed income group exceeds the safe harbour debt percentage, the amount of excess interest to be allocated against foreign attributed income under s FF 5 will be reduced, and in some cases eliminated.

Section FF 6 provides the rules for determining the company’s excess interest allocation percentage, and also provides the formula for determining the amount of excess interest to be allocated against foreign attributed income for the purpose of calculating CTR under s LQ 1. Where the amount of excess interest exceeds foreign attributed income, the balance will be allocated against dividends subject to FDP under s FF 7.

215.100 Application of interest allocation rules — safe harbours [s FF 4]

The calculations required under the interest allocation rules can impose significant compliance costs on taxpayers. Accordingly, companies are not required to apply the interest allocation rules where either of two safe harbours applies. The object of these two safe harbours is to ensure that companies will not be subject to the interest allocation rules unless that company’s foreign attributed income group has highly geared its New Zealand operations, and a significant amount of CTR is at issue.

The interest allocation rules will not apply to a company if:

(a) The CTR to which the company, and any other company associated with that company, are entitled to is less than $50,000; or
(b) The debt percentage of the company’s foreign attributed income group does not exceed 66 per cent.

(1) First safe harbour

Two points should be noted in respect of the first safe harbour. First, the test is applied to the amount of CTR to which the company would have been entitled to if excess interest were not required to be reallocated against conduit income. In practical terms, this means that taxpayers can determine whether or not they meet this safe harbour without making any interest allocation calculations. Secondly, where the company, or any company associated with that company, are not CTR companies, the test applies as if that company, and all companies associated with that company, had elected to be CTR companies.
(2) **Second safe harbour**

Two points should be noted in respect of the second safe harbour. First, the term “foreign attributed income group” is used throughout the interest allocation rules to refer to the company’s New Zealand group. However, the term “foreign attributed income group” in the interest allocation rules should not be confused with the term “New Zealand group” in the thin capitalisation rules, as the two groups will not necessarily be the same. Secondly, the 66 per cent safe harbour debt percentage in the interest allocation rules is lower than the 75 per cent safe harbour debt percentage that applies to the thin capitalisation rules.

215.105 **Identifying the foreign attributed income group** [s FF 8]

If the CTR to which the company, and any other company associated with that company, is entitled amounts to at least $50,000, it will be necessary to determine whether the New Zealand group of companies of which the company is a member has allocated an excessive amount of interest expense to its New Zealand operations, relative to CFCs and FIFs in which it holds interests. The first step in this process is to identify the company’s foreign attributed income group.

Where the company is subject to the thin capitalisation rules (in other words, it is controlled by a single non-resident person), the company’s foreign attributed income group will be the same as its New Zealand group determined under the thin capitalisation rules [see 1000.110]. Note that for the purpose of calculating the New Zealand group under the thin capitalisation rules, the special grouping rules for holding companies in ss FE 28 and FE 29 will not apply.

Where the company is not subject to the thin capitalisation rules, the company’s foreign attributed income group will comprise:

(a) The company itself; and

(b) Any other company with which it has 66 per cent common ownership, and which is resident in New Zealand or carries on business in New Zealand through a fixed establishment.

The reason why the interest allocation rules apply to the New Zealand group of companies as a whole, rather than the company holding a direct interest in a CFC or FIF, is to prevent the New Zealand group of companies being structured in a manner that circumvents the interest allocation rules. For example, in the absence of a group approach, taxpayers could maximise CTR by loading debt on to group companies which do not hold direct interests in CFCs or FIFs. Following the computation of CTR, loss grouping rules would effectively allow the interest expense to be deducted by any group company.

215.110 **Calculating the New Zealand foreign attributed income group debt percentage** [s FF 9]

After identifying the company’s foreign attributed income group, the next step in determining whether an excessive amount of interest expense has been allocated to the group’s New Zealand operations, relative to CFCs and FIFs in which it holds interests, is to calculate the debt level of the New Zealand foreign attributed income group.

The rules for calculating the New Zealand foreign attributed income debt percentage are similar to those used for calculating the New Zealand group debt percentage under the thin capitalisation rules [see 1000.110]. In essence, the New Zealand foreign attributed income group debt percentage is calculated by:

(a) Applying generally accepted accounting practices for consolidation to the foreign attributed income group to eliminate intra-group transactions; and

(b) Measuring the value of assets and debt by using the principles that apply under the thin capitalisation regime; but

(c) Excluding the value of any interests held by a member of the foreign attributed income group in a CFC or FIF calculated under the accounting profits or branch equivalent methods, to the extent that the member of the foreign attributed income group is owned by non-resident shareholders.

The formula is:
percentage of non-resident shareholders × (CFC rights + FIF interests)

Where:
“Percentage of non-resident shareholders” is either:
(a) For a member receiving CTR through a tax credit, the percentage of that member’s non-resident shareholders used to calculate the credit under s LQ 1(2); or
(b) For a member receiving CTR through a reduction in FDP, the average of the percentages of that member’s non-resident shareholders used to calculate the reduction under s RG 7(1).

“CFC rights” is the total value of the rights that the member has in a CFC.
“FIF interests” is the total value of interests that the member has in a FIF.

215.115 Calculating the consolidated foreign attributed income group debt percentage [s FF 10]

Where the New Zealand foreign attributed income group debt percentage exceeds the 66 per cent safe harbour, the company may calculate its consolidated foreign attributed income group debt percentage. The consolidated foreign attributed income group debt percentage differs from the New Zealand foreign attributed income group debt percentage in that it includes the group’s interests in non-grey-list CFCs and FIFs. If the debt percentage for the consolidated foreign attributed income group exceeds the 66 per cent safe harbour, the company will be subject to a higher threshold for determining the extent to which excessive interest has been allocated against the foreign attributed income group.

The consolidated foreign attributed income group debt percentage is calculated as follows:
(a) The value of assets and debts that were used in the calculation of the New Zealand foreign attributed income group form the basis for the calculation.
(b) All assets and debts of non-grey-list CFCs and FIFs in which the foreign attributed income group has an income interest of 40 per cent or more are included in the consolidation.
(c) A percentage of the assets and debts of non-grey-list CFCs and FIFs in which the foreign attributed income group has an income interest of at least five per cent, but less than 40 per cent, are included in the consolidation. For example, if a company in the foreign attributed income group held an income interest of 20 per cent in a CFC or FIF, 20 per cent of the CFC’s or FIF’s assets and debts would be included in the consolidation.
(d) Assets and debts of non-grey-list CFCs and FIFs in which the foreign attributed income group has an income interest of less than five per cent are excluded from the consolidation.
(e) Assets and debts for CFC and FIF interests are consolidated using values taken from their financial accounts.

215.120 Calculating excess interest to be allocated against conduit income [s FF 5]

Once the New Zealand foreign attributed income group debt percentage and the consolidated foreign attributed income group debt percentage have been calculated, the amount (if any) of excess interest which must be allocated against the group’s foreign attributed income is calculated in accordance with the following formula:

interest expenditure × (NZ foreign group debt percentage – relief debt percentage / NZ foreign group debt percentage)

Where:
“Interest expenditure” is the amount allowed as a deduction to companies in the foreign attributed income group as interest expense under ss DB 6 to DB 8 (as modified by s FE 6) or as lessee expenditure in respect of a specified lease under s FZ 2. Interest expenditure does not include intra-group interest and specified lease expenditure.
"NZ foreign group debt percentage" is the New Zealand foreign attributed income group debt percentage calculated under s FF 9.

"Relief debt percentage" is the greater of:

(a) 66 per cent; or

(b) The New Zealand foreign attributed income group debt percentage that would have been calculated under s FF 9; or

(c) The consolidated foreign attributed income group debt percentage calculated under s FF 10 (if the company has chosen to calculate that percentage).

Item (b) above, is a simplified alternative to the debt percentage calculation for the consolidated group. In essence, it allows non-grey-list CFCs and FIFs to be consolidated on the assumption that they are wholly owned by the foreign attributed income group and are fully equity funded (debt raised by the underlying CFCs and FIFs is ignored). While this simplified form of consolidation is unlikely to result in a higher debt percentage than the full consolidation under s FF 10, it is nonetheless more beneficial than not calculating the consolidated foreign attributed income group debt percentage at all.

215.125 Allocating excess interest against foreign attributed income

[s FF 6]

If the application of the formula in s FF 5 results in an excess interest allocation, the next step is determining how it should be applied against conduit income. The excess interest is allocated against net foreign attributed income (foreign attributed income less foreign attributed losses) derived by members of the foreign attributed income group under s FF 6. If the excess interest exceeds net foreign attributed income, the balance will be allocated against dividends subject to FDP under s FF 7.

Allocating excess interest against net foreign attributed income is a two-step process. First, determine what percentage the excess interest represents of the group’s net foreign attributed income. Secondly, determine the amount of the excess interest to be allocated against a group member’s net foreign attributed income for the purpose of calculating CTR under s LQ 1 [see 215.15].

The formula in s FF 6 for determining what percentage the excess interest represents of the group’s net foreign attributed income is as follows:

\[
\text{foreign income} - \left(\frac{\text{company credits}}{\text{tax rate}}\right) \times \text{apportionment percentage}
\]

Where:

“Foreign income” is the foreign attributed income less foreign attributed losses,

“Company credits” is the total BETA credits available to be offset against the income tax liability of all companies in the foreign attributed income group for the tax year (calculated as if no CTR was available under s LQ 1),

“Apportionment percentage” is the amount calculated as below,

“Tax rate” is the basic rate of income tax for companies, expressed as a percentage, for the income year (currently 30 per cent).

The formula to calculate the apportionment percentage is:

\[
\frac{\text{excess amount} \times \text{tax rate}}{\text{tax rate} \times \text{net foreign attributed income} - \text{credits}}
\]

Where:

“Excess amount” is the excess amount of interest expenditure calculated under s FF 5.

“Tax rate” is the basic rate of income tax for companies, expressed as a percentage, for the income year (currently 30 per cent).

“Net foreign attributed income” is the total foreign attributed income less foreign attributed losses of all companies that are part of the conduit company’s foreign group at the end of the income year.
“Credits” is the total BETA credit amounts that can be credited against the income tax liability of all companies in the foreign attributed income group for the tax year (calculated as if no CTR was available under s LQ 1).

215.130 Allocating excess interest against dividends subject to foreign dividend payments [s FF 7]

If the amount of the excess interest expense allocated to all the companies of the foreign attributed income group is less than the total amount of excess interest expense calculated under s FF 5, then the difference is allocated against foreign-sourced dividends subject to FDP derived by companies of the foreign attributed income group under s FF 7.

Allocating surplus interest expense against foreign-sourced dividends subject to FDP is a three-step process. First, determine the group’s surplus interest allocation percentage. Secondly, determine each company’s share of the surplus interest allocation. Thirdly, determine the adjustment to the company’s CTRA.

The formula for determining the group’s surplus interest allocation percentage is as follows:

\[
\text{surplus amount} \times \text{tax rate} \bigg/ \text{group FDP}
\]

Where:

- “Surplus amount” is the difference between the calculations made under ss FF 5(2) and FF 6(4).
- “Tax rate” is the basic rate of income tax for companies, expressed as a percentage, for the income year (currently 30 per cent).
- “Group FDP” is the total DWPFDPs (calculated after claiming net loss offsets in s RA 6 but before CTR in s RG 7 that must be deducted from dividends paid during the tax year to companies of the foreign attributed income group at the end of the tax year.

Note: The group’s surplus interest allocation percentage cannot exceed 100 per cent.

The formula for determining each company’s foreign dividend adjustment amount is as follows:

\[
\text{company FDP} \times \text{surplus percentage} \bigg/ \text{tax rate}
\]

Where:

- “Company FDP” is the total FDPs (calculated after claiming net offsets in s RG 6 but before CTR in s RG 7 ) that must be deducted from dividends paid to the company during the tax year.
- “Surplus percentage” is the percentage figure calculated above.
- “Tax rate” is the basic rate of income tax for companies, expressed as a percentage, for the income year (currently 30 per cent).

The formula for determining the debit in the company’s CTRA is as follows:

\[
\text{income under s FF 7(7)} \times \text{tax rate}
\]

Where:

- “Income under s FF 7(7)” is the company’s foreign dividend adjustment amount referred to in s FF 7(7).
- “Tax rate” is the basic rate of income tax for companies, expressed as a percentage, for the income year (currently 30 per cent).

In essence, this requires the surplus interest allocation to be converted into its tax cash value, which is then allocated against the FDP liabilities of the companies in the foreign attributed income group before CTR is calculated. Where an allocation is made to a company in the foreign attributed income group, that company is deemed to derive assessable income equal to the allocated cash value divided by the company tax rate. In addition, that company’s CTRA will be debited by an amount equal to the amount of assessable income which it is deemed to have derived multiplied by the company tax rate.
Chapter 220
Cook Islands and Niue

220.10 Local income tax imposed in Cook Islands
Local income tax is imposed by the governments of the Cook Islands and Niue on income derived from sources within those territories.

Income derived from the Cook Islands or Niue by a New Zealand resident is assessable for income tax in New Zealand, but credit is given against the New Zealand tax for tax paid in the Cook Islands or Niue [s LJ 2].

220.15 Cook Island National Superannuation Fund
The Cook Island National Superannuation Fund (the “Fund”) was established to provide employees and self-employed people residing in the Cook Islands with a retirement pension. The Fund is governed by a trust deed, and the trustee of the Fund is the Public Trust of New Zealand. Because the trustee is resident in New Zealand, unintended tax consequences potentially arise under New Zealand tax legislation (ie deeming the Fund to be a New Zealand resident). This unintended tax effect has been eliminated by treating a company acting as trustee of the Cook Island National Superannuation Fund as not resident in New Zealand [s YD 2(3), see TIB vol 17:7 (September 2005) at 47].

220.20 New Zealand company deriving income from Niue [ss CW 59(1), (2), (5), IC 13]
The income of a company incorporated in New Zealand is exempt where the company derives its income wholly or mainly from Niue.

Income derived by the company from New Zealand is not exempt, and the exemption does not apply to companies that would fall within the controlled foreign company (CFC) regime if they were foreign companies. These provisions arise because Niue has no Companies Act of its own and Niue companies have traditionally been incorporated under New Zealand law.

The exemption also does not apply to any dividend that constitutes a distribution of an amount derived by the company from sources in New Zealand.

The 66 per cent threshold for offsetting losses within a group of companies can be varied by Order-in-Council for companies involved in the development of Niue — see 940.30.

220.30 Income from Niue development projects [s CW 59(4), (5), (7)]
Income derived wholly or mainly from a business or enterprise carried on by a company in Niue is exempt from income tax in New Zealand if:
(a) The company is incorporated in New Zealand;
(b) The business or enterprise is declared by Order in Council to be a development project; and
(c) The income is derived from sources in Niue.

A business or enterprise may be declared to be a development project if the Governor-General is satisfied that it is entered into wholly or mainly for the purpose of developing Niue, or is or will be important in the
development of Niue. The exemption does not apply to any dividend that constitutes a distribution of an amount derived by the company from sources in New Zealand.

220.50 Dividends derived from New Zealand company deriving Niue income [s CW 59(3), (5)]
Dividends derived in a tax year from a New Zealand company, that derives its income wholly or mainly from Niue is exempt income, unless the dividend is derived by:
(a) A New Zealand resident;
(b) A company that is a controlled foreign company (CFC) at any time during the tax year; or
(c) A trustee of a trust where a settlor or beneficiary is resident in New Zealand during the tax year.
This exemption does not apply to any dividend that constitutes a distribution of an amount derived by the company from sources in New Zealand.

220.60 Exempt trust fund income [s CW 59B]
Income derived by the trustee of the Niue International Trust Fund and the Tokelau International Trust Fund is exempt. Distributions by these funds are also exempt in the hands of the persons deriving them.
Chapter 225

Cooperatives, Statutory Producer Boards, Mutual Associations, Clubs, and Societies

225.10 Mutual associations
For the purposes of the rules applying to mutual associations, “association” means “a body or association of persons, whether incorporated or not” [s YA 1]. The definition is sufficiently wide to include such things as clubs, unions, cooperative companies and statutory producer boards.

The common law principle of mutuality holds that a group of persons cannot make a taxable profit from trading with themselves. Under this principle, a mutual association will have assessable income only to the extent to which it deals outside its circle of membership. In Travel Agents’ Association of New Zealand Inc v Commissioner of Inland Revenue (1979) 4 NZTC 61,417, (1979) 3 TRNZ 155 (SC), it was found that a mutual association is assessable on income derived from transactions with persons outside the circle of membership such as interest on bank deposits.

However, legislation overrides the common law principle of mutuality in certain circumstances. As a result, when calculating its taxable income, a mutual association must ignore the mutuality principle in relation to particular types of transaction.

225.15 Mutual transactions [ss HE 2, YA 1]
The term “mutual transaction” is defined in s YA 1 to mean a transaction of the kind described in s HE 2 (Classes of mutual transaction) entered into between an association and its members, or with members and other persons who are not members.

Section HE 2 lists the following types of transaction:
(a) The borrowing by the association of money from one or more members, but only to the extent to which the money is applied as a loan to a member; and
(b) The lending by the association of money to one or more members.

Where the association is a statutory producer board (other than one that derives only exempt income) the list includes two additional items:
(a) Levies paid by members; and
(b) Produce transactions.

TaxNote: The ITA 2004 defined “mutual transaction” as being:
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(a) The purchase or other acquisition by the association of trading stock from a member of the association;
(b) The sale or other disposition by the association of trading stock to a member of the association;
(c) The supply of any services by a member of the association to the association;
(d) The supply of any services by the association to a member of the association;
(e) The borrowing by the association of money from a member of the association to the extent to which that money is applied in lending money to a member or members of the association;
(f) The lending by the association of money to a member of the association;
(g) In relation to an association that is a statutory producer board, produce transactions, and the payment of levies to the statutory producer board by its members.

This definition, which applied to all mutual associations, was considerably wider than the definition contained in the ITA 2007. It may be that the drafters of the ITA 2007 are of the opinion that these matters are encompassed in the ordinary meaning of the word “transaction”. However, the *ejusdem generis* principle of construction would suggest that this may not be the case. This matter has been referred to Inland Revenue officials for review.

225.20  **Mutual transactions assessable** [s CB 33]

Where an association enters into a “mutual transaction” [see 225.15] with a member, any amount derived from that transaction is taxable to the association. However, the amount is taxable only if it would be income under ordinary concepts were it not for its mutual character. This means that the non-taxable treatment of such things as capital gains is preserved.

Profits that are derived from member transactions are then able to be distributed to the members.

225.25  **Distributions to members — mutual associations** [ss DV 19, HE 3, HE 4]

The mutual association is allowed a deduction for assessable profits distributed as rebates to its members. The amount of the deduction is equal to the lesser of:

(a) The total rebates paid to members in respect of “mutual transactions” [see 225.15] which are included in the association’s income for that income year; or
(b) The profits attributable to mutual transactions, other than profits that have been distributed as an imputed cash distribution. Member and non-member transactions must be apportioned to determine the profits attributable to mutual transactions.

The association is allowed six months after the end of its trading year to make the distribution. A rebate made in respect of non-member transactions is not allowable as a deduction.

225.30  **Distributions to members — cooperative companies** [ss DV 19, HE 3, HE 4]

A cooperative company is defined in the Co-operative Companies Act 1996 as:

(a) A company, the principal activity of which is, and is stated in its constitution as being, a cooperative activity and in which not less than 60 per cent of the voting rights are held by transacting shareholders; or
(b) A company that is a subsidiary of a company referred to in para (a) above and the principal activity of which is, and is stated in its constitution as being, a cooperative activity.

A cooperative activity is defined in the Co-operative Companies Act 1996 as being one or more of the following activities:

(a) Supplying or providing the shareholders of the company with goods or services (or both);
(b) Supplying or providing the shareholders of the company’s holding company with goods or services (or both);
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(c) Processing or marketing goods or services, or both, supplied or provided by its shareholders;
(d) Processing or marketing goods or services, or both, supplied or provided by the shareholders of its holding company;
(e) Entering into any other commercial transaction with the shareholders of the company;
(f) Entering into any other commercial transaction with the shareholders of its holding company;
(g) Supplying or providing goods or services, or both, that are ancillary to, or that otherwise facilitate, the carrying on by the company or its holding company of a cooperative activity — referred to in any of items (a) to (f) above.

A cooperative company does not include a statutory producer board [s YA 1].

Cooperative companies are generally mutual associations and therefore are able to deduct under s DV 19, distributions of profits arising from transactions with its members. The calculation is identical to that for mutual associations [see 225.25].

Cooperative companies and companies wholly owned by cooperative companies are also able to deduct amounts distributed by way of rebate where those profits arise from transactions with persons outside of its membership base. Section CD 34B ensures that the amount distributed is not treated as a dividend. In order for the rebate treatment to apply to the distribution, all of the following conditions must be satisfied:

(a) The cooperative company is resident in New Zealand for the period to which the distribution relates;
(b) If the distribution is being made by a company owned by the cooperative company, that subsidiary company is also resident in New Zealand for the period to which the distribution relates;
(c) The cooperative company has reasonable grounds to believe that the member is resident in New Zealand or has a fixed establishment in New Zealand at the time at which the distribution is made.

An election must be made by the cooperative company (or a wholly-owned subsidiary) for s CD 34B to apply. When the election is made, and all of the above conditions are met, a distribution to a member is not a dividend when and to the extent to which the distribution is for:

- The number of shares held by the member for trading transactions, or projected trading transactions, in the period to which the distribution relates;
- Limited non-transaction shares. These are shares that are not transaction shares or projected transactions shareholding, and which do not exceed 20 per cent of the shares held for trading transactions or projected trading transactions, whichever is the lesser.

In some cases, the constitution of a cooperative may permit a member to hold shares that exceed the number required for transactions or projected transactions by more than 20 per cent. These additional shares, in some cases, entitle the member to enter into trading transactions. Where this occurs, the non-dividend treatment allowed under s CD 34B applies only to the shares which are held by the member for trading transactions, or projected trading transactions. It does not apply to any excess shares.

Trading transactions are those transactions which involve the sale of trading stock which is tangible property, and which is not sold as part of the disposal of a business.

Under s 125(2) of the Companies Act 1993, a cooperative is required to fix a date for making a resolution to make a distribution to members, which date must be not be more than 20 working days before the resolution is made. However, this 20 day rule does not apply in respect of entitlement to distributions for transaction shares, projected transactions shareholdings, limited non-transactions shares and excess shareholdings, where:

- The cooperative or subsidiary gives a copy of the election for s CD 34B to apply, to the Registrar of Companies, before the distributions are paid; and
- A date has been fixed under s 125(1) of the Companies Act 1993 for making a distribution to members before their entitlement to distributions arises, and that date is within the year or period to which the distributions relate.
Amounts that are excluded by s CD 34B from being a dividend are deductible to the cooperative company under s DV 11.

225.35  Distributions to members — statutory producer boards [ss DV 19, HE 3, HE 4]

Statutory producer boards comprise the following bodies:
(a) New Zealand Horticulture Export Authority;
(b) New Zealand Meat Board;
(c) New Zealand Pork Industry Board;
(d) Marketing authorities under the Primary Products Marketing Act 1953;
(e) Any primary producer board or marketing board established by any Act.

In the case of statutory producer boards, the allowable deduction is the amount of the rebates paid to members in respect of mutual transactions which are included in the income of the statutory producer board. The statutory producer board may elect whether the rebate is deductible in the year of payment or in the year in which the relevant member transactions took place. Where a member of the statutory producer board is itself a mutual association, the rebate is deemed to be assessable to that member in the income year in which the rebate is deductible to the statutory producer board.

For statutory producer boards, the definition of “mutual transaction” includes not only:
(a) The borrowing by the association of money from a member to the extent to which that money is applied in lending money to a member or members; and
(b) The lending by the association of money to a member;
but also the payment of levies by members and produce transactions.

“Produce transactions” are defined in s YA 1 to mean transactions that are between a statutory producer board and its members, and involve the acceptance by the board from its members (in terms of the board’s primary statutory functions) of produce that is trading stock or goods that are trading stock.

Statutory producer boards are also able to make cash distributions and notional distributions, both of which are able to have imputation credits attached to them [see 670.85].

225.40  Taxation of the rebate in the hands of the recipient [s CB 34]

Any part of a rebate from a mutual association, which arises through business transactions of the member with the association, is income in the member’s hands. Any part of the rebate relating to a member’s non-business transactions is tax-free. Where the total rebate paid by the association exceeds the profit attributable to member transactions, the excess is income to the member. If the association is a company, the excess is deemed to be a “dividend” to the member and assessable as such. Imputation credits may be attached.

A rebate is deemed to have been paid to a member when it is credited in account in the books of the association or otherwise dealt with in the interest or on behalf of the member (for example, by off-setting the amount against the member’s account with the association).

Where a rebate is satisfied by:
(a) The issue of fully paid-up or partly paid-up shares in the association; or
(b) Giving credit for the whole or part of the amount unpaid on any shares in the association, that rebate is deemed not to be a bonus issue.

225.45  Taxation of statutory producer boards [s OC 3, sch 37]

Statutory producer boards are taxable on their income. They are deemed to be companies carrying on a business. Levies charged (other than those specifically for capital development) are assessable. Expenditure incurred is deductible in the normal manner.

A statutory producer board is a mutual association in which “member” means any person who:
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(a) Is liable to pay a levy to the board; or
(b) Supplies produce or goods to the board.

Where the statutory producer board is an imputation credit account company, imputation credits may be attached to dividends that are cash distributions or notional distributions.

A statutory producer board falls within the definition of special corporate entity [s YA 1]. The principal effect of a statutory producer board being a special corporate entity is that it is treated as an ultimate shareholder, except where the statutory producer board derives only exempt income.

225.50 Friendly societies [ss CW 44, YA 1]

A “friendly society” is any society or credit union or association of credit unions registered or deemed to be registered under the Friendly Societies and Credit Unions Act 1982. The income of a friendly society is exempt from income tax with the exception of income which is derived from:

(a) Business carried on beyond the circle of its membership; and
(b) A company registered as an insurer under the Accident Insurance Act 1998.

Investment income derived by a friendly society, which is not derived from a business carried on with non-members, is exempt.

225.55 Clubs generally

The mutuality principle applies in that taxpayers cannot derive assessable income, or incur a deductible loss, from dealing with themselves. Profits or surpluses arising from business transactions entered into by a club or association with its members are included in the assessable income of the association. In order for the transaction to be a business transaction, it is necessary that the club or association be carrying on a business. Clubs and societies are not assessable on member transactions or on non-member transactions that meet the following criteria:

(a) The transactions are conducted on premises under the control of the non-profit organisation;
(b) The non-member transactions are indistinguishable from member transactions; and
(c) The relevant activities are conducted substantially for the enjoyment and participation of members.

In practice, this policy is limited to members and to non-members who are bona fide guests, members of other clubs enjoying reciprocal rights, and potential members being introduced to the facilities. The type of transactions to which this policy applies are bar and kitchen takings, raffles, and other fund raising conducted primarily with members, and proceeds from gaming machines after allowing for gaming machine duty. Generally, these transactions meet the criteria listed above.

The types of transactions with non-members to which the exemption policy does not extend include the rental of facilities and interest income, both of which are assessable. Where the club receipts include assessable income, the total expenses must be apportioned between exempt income and assessable income.

225.60 Clubs and non-profit making organisations — deductions [s DV 8]

Clubs and other non-profit organisations are entitled to a deduction of the lesser of $1,000 or the amount of their net income prior to taking the deduction. The provision applies to both incorporated and unincorporated organisations provided that:

(a) It does not have the purpose of making a profit for any proprietor, member or shareholder; and
(b) Its constitution prohibits it from making a distribution of property to any proprietor, member or shareholder.

The types of organisations that qualify are trade associations, progressive associations, political parties, and social clubs that do not qualify for the exemption given to sporting clubs [see 225.65]. Bodies corporate do not qualify for the deduction as s 15(3) of the Unit Titles Act 1972 permits them to distribute money and personal property to the proprietors [see TIB vol 6:4 (October 1994) at 5].
In *Travel Agents’ Association of New Zealand Inc v Commissioner of Inland Revenue* (1979) 4 NZTC 61,417, (1979) 3 TRNZ 155 (SC), the exemption applies only where the club members are prohibited from obtaining any private gain.

**225.65 Amateur sports clubs — general tax exemption** [s CW 46]

Income derived by any society or association established substantially or primarily for the purpose of promoting any amateur sport or game is exempt. The following criteria apply:

(a) The game or sport is for the recreation or entertainment of the general public; and

(b) No part of the income or funds is used or available to be used for the private pecuniary profit of any proprietor, member, or shareholder or of an associated person thereof.

The question as to whether a society or association comes within the provisions of this section is left to the determination of Inland Revenue and it has been decided that the following classes of organisations are entitled to exemption:

(a) District and National Wrestling Associations;

(b) District and National Boxing Associations;

(c) Rugby League Clubs and Associations;

(d) Clubs and Associations connected with amateur cricket, tennis, golf, rugby, and association football;

(e) Generally, any body or organisation established for the promotion of any amateur game or sport.

Where these conditions are met, a sports body is exempt from tax on all income (including income from interest and rents). If these conditions are not met, the sports body is assessable on net income from all sources, except that derived from members’ subscriptions.

The exemption extends to non-residents, provided all other requirements of s CW 46 are met [see TIB vol 10:9 (September 1998) at 7-9].
Chapter 230

Core Provisions — Purpose and Application

230.05 Purpose and application [ss A 2, AA 1]
The main purposes of Part A of the ITA 2007 are to:
(a) Define and impose tax on net income;
(b) Impose obligations concerning tax; and
(c) Set out rules to calculate tax and to satisfy the obligations imposed.
The ITA 2007 applies to income derived in the 2008-2009 and later tax years or corresponding income years. The ITA 2004 is repealed in respect of the 2008-2009 and later tax years or corresponding income years, but continues to have full effect for earlier years.

230.10 Interpretation [s AA 2]
Diagrams, flowcharts, readers notes and lists of defined terms at the end of sections in the ITA 2007 are included only as aids to interpretation. If there is a conflict between a diagram and a provision of the ITA 2007, the provision governs. If a defined term is used in a section, but is not included in the list of defined terms for that section, the term is to be used as it is defined.
In reviewing the principles of statutory interpretation, the Court of Appeal has held that:
(a) It is fundamental to all statutory interpretation that words are to be given their ordinary meaning;
(b) Where words are capable of more than one meaning and the object of the legislation is clear, the words must be given such fair, large, and liberal construction as will best ensure the attainment of the object of the Act;
Where words are unclear, or are reasonably capable of more than one meaning, the Court prefers an interpretation which does not lead to injustice or absurdity, and one which accords with the evident purpose; and

The true meaning must be consonant with the words used, having regard to their context in the Act as a whole, and to the purpose of the legislation to the extent that this is discernible.

In Pepper (Inspector of Taxes) v Hart [1992] 3 WLR 1032 (HL) the Court was prepared to look at extraneous material (such as Hansard) that related to the background against which the legislation was enacted. This indicated a clear departure from according preference to the literal interpretation: Commissioner of Inland Revenue v Alcan New Zealand Ltd [1994] 3 NZLR 439, (1994) 16 NZTC 11,175 (CA).

Definitions [s AA 3]

Definitions of words and terms that are defined for purposes of the ITA 2007 and general provisions relating to the interpretation and construction of the legislation are found in Part O.

Purpose [s BA 1]

The two main purposes of Part B of the ITA 2007 are to:

(a) Impose income tax, provisional tax, withholding liabilities, and other tax obligations; and

(b) Set out procedures to be followed to calculate tax and satisfy tax obligations.

It also provides a basis for applying the other parts of the ITA 2007 and generally sets up the main links between its Parts.

The following diagram illustrates the structure of Part B.
230.25 **Obligations of taxpayers** [ss BB 2, BB 3]

All persons must calculate and satisfy their income tax liability in accordance with subpart BC of the ITA 2007.

All persons must:
(a) If they are provisional taxpayers, pay provisional tax for each income year in accordance with the provisional tax rules;
(b) Satisfy any withholding liabilities of the person in accordance with subpart BE; and
(c) Satisfy any obligations of the person that are specified in subpart BF.

The CIR is empowered to counteract any tax advantage which arises from a tax avoidance arrangement.

Persons affected by a double tax agreement must satisfy their obligations for income tax under the agreement.

230.30 **Taxpayer types and tax calculation** [s BC 1]

Taxpayers are classified as being one of the following:
(a) *Non-filing taxpayers*: whose income tax liability is the total tax withheld from their annual gross income;
(b) *Filing taxpayers with schedular income*: for the year, whose income tax liability is calculated under s BC 7 [see 230.35]; or
(c) *Filing taxpayers*: whose income tax liability is calculated under ss BC 2 to BC 6.
230.35 **Taxpayer with schedular income** [s BC 7]

“Schedular income” means income of the following types [s YA 1]:

(a) Non-resident passive income under s RE 4;
(b) Policyholder income of a life insurer under s CR 1(4);
(c) Income derived from a mining venture by a non-resident mining operator;
(d) Specified living allowances derived by a non-resident entertainer who does not elect to file a return;
(e) Category A income derived by a trustee of a group investment fund;
(f) Income derived by a multi-rate PIE;
(g) Income derived by a non-resident general insurer under s YD 8;
(h) Income derived by a non-resident shipper under s YD 6; and
(i) Income derived by non-resident film renters under s YD 7.

The income tax liability for an income year of a taxpayer who has any schedular income for that year is the total schedular income tax liability, as calculated below, plus the amount that would be the taxpayer’s income tax liability for the year if the taxpayer had no schedular income.

If a taxpayer has one type of schedular income for an income year, the schedular income tax liability is the amount that would be the income tax liability if the only income for the year were that schedular income. Where there is more than one type of schedular income, the schedular income tax liability is the total of the schedular income tax liabilities, each calculated separately.

230.40 **Income and deductions** [ss BC 2, BC 3, BD 1, BD 2]

A taxpayer’s annual gross income for a tax year is the total of the amounts of the taxpayer’s assessable income that are allocated to the corresponding income year [s BC 2].

An amount is income of a taxpayer if it is income under Part C of the ITA 2007. A taxpayer’s assessable income is any income which is not exempt income, excluded income or foreign sourced income of a non-resident [s BD 1].

An amount is a deduction if deduction is granted under Part D [s BD 2].

A taxpayer’s annual total deduction for a tax year is the total of the taxpayer’s deductions that are allocated to the corresponding income year [s BC 3].
SUBPART BD

BD 1
Assessable income

BD 2
Deductions

BD 3
Allocation of assessable income

BD 4
Allocation of deductions

Annual gross income

Annual total deduction

Assessable income
Deductions

PART I
Losses

Net loss if negative

Net income if positive or zero

Net income

Net income less

Available net losses

Available net losses equals

Taxable income

Income tax liability
230.45 Allocation of income [s BD 3]
Each amount of income must be allocated to an income year.
The general rule is that items of income are allocated to the income year in which they are derived. However, where a provision of any of Part C or Part E to Part I provides for an allocation on another basis, that provision takes precedence.
In determining when an amount has been derived, regard must be had to case law which requires some people to recognise income on cash basis and others on an accrual basis, and generally defines the concept of derivation. Any income which has been credited in account or dealt with on behalf of, or in the interests of, the taxpayer are treated as having been derived.
An amount of income can be allocated only once. Therefore, it cannot fall to be taxed in two income years.

230.50 Allocation of deductions [s BD 4]
Every deduction must be allocated to an income year.
The general rule is that the deduction is allocated to the income year in which the expenditure or loss is incurred. However, where a provision in Part D to Part I provides for allocation on another basis, that provision takes precedence.
In determining when an amount of expenditure or loss has been incurred, regard must be had to case law which requires some people to recognise income on cash basis and others on an accrual basis and also more generally defines the concept of “incurred”.
Where an amount is required to be apportioned over more than one income year, the total of the amounts allocated can be no greater than the amount of the expenditure or loss so that no double deduction occurs.

230.55 Net income and net loss [s BC 4]
If a taxpayer’s annual gross income is more than the annual total deduction, the difference is the net income for the year. If a taxpayer’s annual gross income equals the annual total deduction, the net income for the year is zero.
If a taxpayer’s the annual gross income is less that the annual total deduction, the difference is the net loss for the year, and the taxpayer is deemed to have net income for the year of zero.
A taxpayer with a net loss for an income year may (under Part I of the ITA 2007):
(a) Subtract it from net income for a future year; or
(b) Make the net loss available to another taxpayer for offset against that other taxpayer’s net income in that or a future income year.
The latter of these two options is available only to group companies [see 940 LOSSES].

230.60 Taxable income [s BC 5]
A taxpayer’s taxable income for an income year is determined by subtracting any available tax losses from the taxpayer’s net income under Part I (treatment of tax losses).

230.65 Income tax liability [s BC 8]
With the exception of non-filing taxpayers, a taxpayer’s income tax liability for an income year is calculated in accordance with the diagram below.
The income tax liability of the taxpayer for the income year is obtained by multiplying the taxable income for the tax year by the applicable basic tax rate. This is adjusted by subtracting the allowable credits. If the resulting amount is more than zero, that amount is the taxpayer’s terminal tax liability which must be paid. If the resulting amount is zero, the taxpayer’s income tax liability for the income year is zero. If the resulting amount is negative, the taxpayer has surplus credits. Depending on the type of credit, these may be extinguished or may be refundable under subpart LA.
Tax credits are sued to satisfy income tax liabilities in the following order:
(a) Non-refundable credits;
(b) Tax credits for supplementary dividends;
(c) Imputation credits; and
(d) Refundable tax credits.

The diagram below (taken from s BC 6) illustrates the process used by taxpayers (except non-filing taxpayers) to calculate income tax liability.
230.70 Surplus credits [ss BC 8, LA 4, LA 5, LA 6, LA 7, LA 8]

(1) Non-refundable credits
Non-refundable credits are

(a) Tax credits under subpart LC (other than tax credits for housekeeping) including:
   (i) Tax credits for persons on low incomes [s LC 1];
   (ii) Tax credits for child’s income [s LC 3];
   (iii) Tax credits for transitional circumstances [s LC 4];
   (iv) Tax credits for absentees [s LC 9].
(b) Tax credits under subpart LJ (tax credits for foreign income tax);
(c) Tax credits under subpart LK (tax credits relating to attributed controlled foreign company income);
(d) Tax credits under subpart LQ (tax credits of conduit tax relief companies);
(e) Tax credits under subpart LR (tax credits for policyholder income);
(f) Amounts in a BETA account or policyholder credit account that the person chooses to use in payment of income tax; and
(g) Credits allocated to the person by a multi-rate PIE or an investor proxy.

To the extent to which non-refundable credits are not used to satisfy the person’s income tax liability for the year, they are extinguished.

(2) Tax credits for supplementary dividends
A company can utilise surplus tax credits for supplementary dividends by using the rules contained in s LP 3. This includes carrying the credit forward or transferring it to another company in the same wholly owned group of companies [see 1010.31 and 1010.32]. For other taxpayers, any surplus credit is extinguished.

(3) Imputation credits
Companies, trustees (other than the Maori trustee) and Maori authorities are able to convert excess imputation credits to a tax loss for carry-forward to a future income year [s LE 2]. Other taxpayers are able to carry the excess credit forward for use in the following income year [s LE 3].

(4) Refundable tax credits
To the extent to which the excess tax credit is for:

(a) PAYE;
(b) Provisional tax payments;
(c) Resident withholding tax;
(d) RSCT (retirement scheme contribution tax);
(e) Foreign dividend payment (FDP) credits;
(f) Tax credits for expenditure on research and development; or
(g) Maori authority credits.
The Commissioner must:

(a) First, use a tax credit to satisfy any outstanding tax liability for previous years;
(b) Secondly, transfer the excess credit to another person if the taxpayer requests that this be done; and
(c) Thirdly, refund the surplus credits.

TaxNote: Both the FDP rules and conduit tax relief rules have been repealed and foreign dividends derived by a New Zealand resident company are exempt from tax, both with effect from the beginning of the first income year commencing on or after 1 July 2009 [see 850 INTERNATIONAL TAX REGIME, 215 CONDUIT TAX RELIEF].
230.80 Withholding liabilities [s BE 1]
A person who makes a PAYE payment must make a deduction from the payment in accordance with the PAYE rules [see 1080 PAYE].
A person who makes a payment of resident passive income must make a deduction from the payment in accordance with the RWT rules [see 1260 RESIDENT WITHHOLDING TAX].
A person who makes a payment of non-resident passive income must make a deduction from the payment in accordance with the NRWT rules [see 1020 NON-RESIDENT WITHHOLDING TAX].
A person who provides a fringe benefit to another person must pay fringe benefit tax in accordance with the FBT rules [see 540 FRINGE BENEFIT TAX].
A person who makes an employer’s superannuation cash contribution to a superannuation fund must pay ESCT (employer’s superannuation contribution tax) in accordance with the ESCT rules [see 1390 SUPERANNUATION].
A person who makes a retirement scheme contribution to a retirement savings scheme must pay RSCT under the RSCT rules.

230.85 Other taxpayer obligations [s BF 1]
A person is obliged to also make the following payments where applicable:
(a) Qualifying company election tax [see 1160 QUALIFYING COMPANIES].
(b) Income tax on taxable distributions from non-qualifying trusts [see 1420 TRUSTS AND ESTATES].
(c) Withdrawal tax (savings in special farm, fishing vessel, or home ownership accounts) [see 1395.80].
(d) Further income tax payable by a company where there is an end of year debit balance in the imputation account, or when the company ceases to be an imputation credit account company [see 670 IMPUTATION].

230.90 Avoidance [s BG 1]
A tax avoidance arrangement is void as against the CIR for income tax purposes. The CIR, in accordance, may counteract a tax advantage obtained by a person from or under a tax avoidance arrangement [see 80 AVOIDANCE].

230.95 Double tax agreements [s BH 1]
A double tax agreement is an agreement that has been negotiated between:
(a) The New Zealand Government and the Government of any foreign territory; or
(b) The New Zealand Commerce and Industry Office and the Taipei Economic and Cultural Office in New Zealand,
and has been declared by the Governor-General, by Order in Council, to have entered into force.
Such a double tax agreement may:
(a) Provide relief from double taxation;
(b) Provide relief from tax;
(c) Tax the income of non-residents derived from any source in New Zealand;
(d) Determine the income to be attributed to non-residents or their agencies, branches, or establishments in New Zealand;
(e) Determine the income to be attributed to New Zealand residents who have special relationships with non-residents;
(f) Prevent fiscal evasion;
(g) Facilitate the exchange of information; and
(h) Assist in the recovery of unpaid tax.

The provisions of a double tax agreement over-ride the provisions of the Revenue Acts. However, an agreement for the recovery of unpaid tax is subject to Part 10A of the TAA.

A reference in a double tax agreement to the profits of an activity or business is to be read, if possible, as a reference to the amount that would be a taxpayer’s net income if that activity or business were the taxpayer’s only activity or business [see 310 DOUBLE TAX AGREEMENTS].

A reference in a double tax agreement to two persons being unrelated is to be read, if possible, as being a reference to two persons not being associated [see 310 DOUBLE TAX AGREEMENTS and 70 ASSOCIATED PERSONS AND RELATIVES].
## Chapter 240

### Deductions

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#### 240.05 Fundamental legislation allowing deductions [ss BD 2, BD 4, BC 3]

Under the core provisions, a taxpayer is required to determine “annual total deduction” for an income year as one of the steps in calculating the income tax liability for that year. Annual total deductions are the sum of all amounts of deductions which are allowable for tax purposes and which are allocated to that income year. The calculation of this figure requires an understanding of both the criteria for determining whether an expenditure or loss is allowable as a deduction and how the timing rules apply to that deduction.

No amount is allowed as a deduction unless deductibility is granted under Part D of the ITA 2007. The fundamental rule for determining what is allowable as a deduction is called the “general permission” and is located in s DA 1. This fundamental rule is then modified by a series of “general limitations” which deny deduction for particular types of expenditure. The general limitations are located in s DA 2.

These general rules can then be modified by specific rules which either provide for a deduction that would not otherwise be available or deny a deduction that would otherwise be available.

Some of these specific rules “supplement” the general permission. This means that the general permission does not need to be satisfied in respect of that deduction. Where this occurs, the provision will specifically state that it supplements the general permission. An example is s DB 7 which allows a company to deduct an interest expense without the need for a nexus with income to exist.

Even where a provision supplements the general permission, it remains subject to the general limitations unless the provision specifically states that it overrides the general limitations. An example of where this occurs is s DB 11 which governs the treatment of a negative base price adjustment under the financial arrangements rules.

#### 240.10 Legislation and common law principles [ss DA 1, DA 2]

The general rule for deductibility is found in s DA 1. It is called the “general permission”. The general permission allows a deduction for any expenditure or loss to the extent to which it satisfies the nexus test between the expenditure or loss incurred and the derivation of income or being incurred by business carried on for the purpose of deriving income. The general permission allows a deduction to the extent to which the expenditure or loss is either:

(a) Incurred by a taxpayer in deriving the taxpayer’s assessable income or excluded income or a combination of both; or

(b) Incurred by the taxpayer in the course of carrying on a business for the purpose of deriving assessable income or excluded income or a combination of both.

The words “to the extent” indicate that an item of expenditure may be apportioned between a deductible amount and a non-deductible amount. This will occur where the expenditure was not incurred wholly in...
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240.15 General principles underlying the legislation [s DA 1]

The general permission [s DA 1] refers to expenditure or loss that is incurred in deriving assessable or excluded income. Although the wording of this rule has changed over time in the ITA 1976, ITA 1994, Taxation (Core Provisions) Act 1996, ITA 2004, and the ITA 2007, the Courts are likely to continue to apply the same principles, which developed over a number of years, in respect of the tests for deductibility.

In order to be deductible, the expenditure need not necessarily be incurred in the income year in which the income flowing from it is derived. However, under the timing rules, which are located in Part E of the Act, expenditure may be allocated to a year other than the year in which it is incurred. For example, the allowable deduction for some prepaid expenditure is allocated to the year in which the goods are used or services physically provided [see 1140 PREPAYMENTS].

Some of the other general principles that have emerged from the Courts in relation to deductibility and timing are:

(a) The Courts tend to adopt commercial accountancy principles in deciding whether particular items are an allowable deduction. This concept is overridden by any specific provision to the contrary.

(b) The legislation should not dictate to a taxpayer how to carry on a business or what expenditure should or should not be incurred in so doing. If the taxpayer chooses to imprudently incur expenditure, it is still an allowable deduction provided that the nexus test is satisfied and it is not otherwise prohibited from deduction by a specific provision. Similarly, there is no authority for amounts expended by a taxpayer to be reduced to what another more prudent taxpayer would have incurred. However, if a taxpayer incurs expenditure partly for business purposes and partly to produce a non-business benefit, the allowable deduction is limited to the expenditure relating to the business purpose: Buckley & Young Ltd v Commissioner of Inland Revenue [1978] 2 NZLR 485, (1978) 3 NZTC 61,271 (CA).

(c) For an expenditure or loss to qualify as an allowable deduction, there must be a sufficient nexus or relationship between the expenditure or loss and the business or vocation carried on. Similarly, the expenditure or loss must be incurred in deriving the income and not be a distribution of the income after it has been derived. For this reason, dividends from a company or distributions of partnership income are not an allowable deduction. In relationship to sponsorship, the CIR takes the view that “advertising” and “donations” are mutually exclusive terms, but does accept that it may be a proper business decision to pay more for an advertising campaign run in conjunction with a charitable or fund-raising campaign.
(d) To qualify as an “expenditure or loss” there must be either the outlay of money or a laying out of something convertible into money. In TRA Case J32 (1987) 9 NZTC 1,187 a contribution to a union’s leave bank did not qualify under this criteria.

(e) In TRA Case M107 (1990) 15 TRNZ 145, when losses from share transactions were disallowed, it was held that although there was the start of a structure to undertake business operations for the carrying on of a business, the taxpayer had not started to carry on a business undertaking. The purchase of the shares was merely an investment, a capital item that had been recorded in the taxpayer’s balance sheet as such. See also comments in Commissioner of Inland Revenue v Banks [1978] 2 NZLR 472, (1978) 3 NZTC 61,236, (1978) 2 TRNZ 323 (CA) and Grieve v Commissioner of Inland Revenue [1984] 1 NZLR 101, (1984) 6 NZTC 61,682, (1983) 6 TRNZ 461 (CA).

(f) In TRA Case K50 (1988) 10 NZTC 411 it was stated:

“For … expenditure to be a deduction … the benefit obtained or to be obtained is related to an expending or passing out from the person claiming the deduction. A book entry is merely a record of the expending or passing of action or the liability of the person committed to that expense. If such a passing out is never to occur in one form or another then it is not a true record … it must be ignored.”

(g) A payment of an outgoing may be a step towards the production of income. To justify a deduction it is not necessary to show a connection between the outgoing and any particular item of income. If the payment is made in the course of gaining or producing assessable income and it is not specifically excluded from deduction, it is deductible: Ash v Commissioner of Taxation (New South Wales) (1938) 61 CLR 263, (1938) 1 AITR 447 (HCA).

240.20 Meaning of incurred [s BD 4]

A deduction is not allowed for any expenditure or loss unless, and until, the expenditure or loss has been incurred. “Incurred” thus has elements of both obligation, and timing. The term is closely related to the accounting concept of “recognition”, under which an expense or loss is recognised only when it is probable that a consumption of benefits (eg a payment) has occurred or will occur, and that the consumption of benefits can be reliably measured.

Section BD 4 provides that, in determining when an item of expenditure has been incurred, regard must be had to case law.

An expenditure or loss can be said to be incurred when the taxpayer is definitively committed to it, even if there has been no actual disbursement: Federal Commissioner of Taxation v James Flood Pty Ltd (1953) 88 CLR 492 (HCA), 506.

Example:

A taxpayer places an order for supplies on 10 March. The supplies are delivered, and an invoice is issued, on 24 March. The taxpayer pays for the supplies on 19 April. The placing of the order does not of itself give rise to the expenditure being “incurred” because, at that date, the taxpayer has no liability for payment. Once the supplies are delivered on 24 March, the taxpayer has incurred the expenditure because the goods have been delivered and the taxpayer has a liability to make payment for them, even though actual payment is not made until 19 April.

In the vast majority of situations, it will be obvious that an expenditure or loss has been incurred because goods or services will have been supplied and an invoice issued. Difficulty in determining if and when an expenditure has been incurred arises only in more unusual situations, which have given rise to a number of cases: Commissioner of Inland Revenue v Glen Eden Metal Spinners Ltd (1990) 12 NZTC 7,270 (CA) at 750.13 and Commissioner of Inland Revenue v Lyndale Motors (1972) Ltd (1991) 13 NZTC 8,076 (HC).

The following guidelines (based on Ogilvy & Mather Pty Ltd v Federal Commissioner of Taxation (1990) ATR 841, 90 ATC 4,836 (FCA)) will assist in determining if (and when) an expenditure or loss has been incurred.

An expenditure or loss may be incurred:
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(a) Even if the amount is not paid in the income year, provided that the taxpayer has completely subjected themselves to that liability;
(b) If it represents a present liability then due, although payable in the future;
(c) Even if it is defeasible; and
(d) Even if there is no existing legal liability to make payment at all, at least where it is certain that the amount will be paid in the future, provided it is otherwise incurred.

An expenditure or loss will not be incurred:

(a) Where it does not represent a pecuniary liability in the income year even if it is certain that the outgoing will arise as a pecuniary liability in the future.
(b) In an income year if it is no more than contingent, pending, threatened, or expected, regardless of how certain it may be that the expenditure or loss will occur in the future.

A reasonable estimate of an expenditure or loss payable in the future will be incurred where it represents a pecuniary liability encountered in the income year, provided it is capable of reasonable estimation.

The meaning of “incurred” was extended by the decision in Commissioner of Inland Revenue v Mitsubishi Motors New Zealand Ltd [1995] 3 NZLR 513, (1995) 17 NZTC 12,351 (PC) in which the Privy Council held that the taxpayer had incurred future estimated warranty expenditure in the year in which warranted vehicles were sold. The Court considered that the past experience of warranty claims justified the view that the expenditure was incurred at the time of the sale even though a warranty claim had not occurred at that time.

Inland Revenue has issued an interpretation statement on the meaning of “incurred” in the light of the Mitsubishi Motors decision [see TIB vol 10:6 (June 1998), Appendix].

TaxNote: In TRA Decision No 14/07 (Unreported, 23 November 2007), accounting fees for the preparation of the 2003 financial statements and returns of income were not incurred until the 2004 income year when the work was actually done. Therefore the deduction was not available in the 2003 income year as claimed.

240.25 Quantum of liability not ascertained in income year

Where a loss or liability is incurred in the course of carrying on a business, the exact amount of which is not ascertained until a later year, the normal allocation rules apply even though the quantum of the expenditure is ascertained in a later year. In practice, estimates are made of the quantum. The Courts have accepted that estimates are a necessary part of calculating some types of allowable deductions: Commissioner of Inland Revenue v Mitsubishi Motors New Zealand Ltd [1995] 3 NZLR 513, (1995) 17 NZTC 12,351 (PC); Commissioner of Inland Revenue v Banks [1978] 2 NZLR 472, (1978) 3 NZTC 61,236, (1978) 2 TRNZ 323 (CA); Commissioner of Inland Revenue v National Bank of New Zealand Ltd (1976) 2 NZTC 61,150, (1976) 2 TRNZ 70 (CA); and Colonial Mutual Life Assurance Society Ltd (Life Branch) v Commissioner of Inland Revenue (1994) 16 NZTC 11,341, (1994) 19 TRNZ 74 (HC).

240.30 Remission of expenditure [s CG 2]

A taxpayer who incurs expenditure in an income year, but does not satisfy that liability during that year, will take that expenditure into account in calculating taxable income for that year because it is assumed that the debt will be paid in due course. If the debt is not paid, and is later remitted or cancelled, the amount remitted is income of the taxpayer. The income arises in the income year in which the remission or cancellation occurs.

Remission or cancellation includes discharge of the debt for inadequate consideration, discharge of a debt under insolvency or bankruptcy law, release by way of a deed or agreement of composition with creditors and lack of enforceability due to lapse of time.

This provision does not apply where the amount of the remission is dealt with under the financial arrangement rules [see 470 FINANCIAL ARRANGEMENTS].

240.35 No deductions for capital [s DA 2(1)]

Unless specifically allowed under Part D of the ITA 2007, no deduction is allowed for any expenditure or loss to the extent to which it is of a capital nature. However, this does not prevent a deduction for deemed
expenditure under the financial arrangements rules. An important modifier to this rule is found in s DB 23, which ensures that the capital prohibition does not apply to expenditure incurred as the cost of revenue account property. This provision is intended to reflect the case law established by Commissioner of Inland Revenue v Inglis (1992) 14 NZTC 9,180 (CA).

Because the nature of an expenditure can only be established on the basis of the facts of the case, the Courts have developed a list of guiding factors to assist in determining whether an expenditure is capital in nature to any extent: Commissioner of Inland Revenue v McKenzies New Zealand Ltd (1988) 10 NZTC 5,233 (CA), Christchurch Press Co Ltd v Commissioner of Inland Revenue (1993) 15 NZTC 10,206 (HC), and BP Australia Ltd v Federal Commissioner of Taxation [1966] AC 224, (1965) 112 CLR 386, (1965) 9 AITR 615 (PC). In these cases, the Courts considered:

(a) The need or occasion which called for the expenditure;
(b) Whether the expenditure was made from fixed or circulating capital;
(c) Whether the payment was of a once and for all nature producing assets or advantages that are an enduring benefit;
(d) How the payment would be treated on ordinary principles of commercial accounting; and
(e) Whether the payment was expended on the business structure of the taxpayer or whether it was part of the income earning process.

Feasibility studies often cause concern as to whether or not the expenditure incurred in carrying out the study are deductible. The CIR has issued an interpretation statement IS 08/02 which discusses the issue. Although the statement does not focus on any particular type of expenditure or deductibility provisions, it does reinforce the basic rules, being:

(a) Expenditure incurred prior to the commencement of a business is not deductible;
(b) If the expenditure is capital in nature, it is not deductible; and
(c) Expenditure is not deductible unless it is incurred in deriving assessable income and as an ordinary incident of the business or income-earning activity.

Business does not commence until the profit-making structure is in place. Therefore, it is necessary to determine the point in time at which the business has progressed to the stage where it has “commenced” for tax purposes.

1) Case law

In Mt Isa Mines Ltd v Federal Commissioner of Taxation 92 ATC 4,755 (HCA), it was held that expenditure incurred for the purpose of improving land as a site for carrying on a business must be regarded as a capital item provided that money is not spent merely on maintenance or upkeep. When expenditure is related to the improvement of the site on which business is conducted, and the improvement is of an enduring and not a transient character, that expenditure is favoured as being of a capital nature. It is not relevant that the taxpayer does not acquire a tangible asset; it is enough that the taxpayer obtains an enduring advantage.

Lockwood Buildings Ltd v Commissioner of Inland Revenue (1996) 17 NZTC 12,483 (HC) involved management fees paid to a parent company to care for management and strategic planning matters. These fees were held to be of a revenue nature and deductible when the parent company provided services (which included investigating the possible acquisition of timber mills and State forests) and the fees payable were based on the profits made by each subsidiary, rather than in relation to services actually performed for that subsidiary.

In Lyttelton Port Co Ltd v Commissioner of Inland Revenue (1996) 17 NZTC 12,556 (HC), the Lyttelton Port Company set up a trust which borrowed money to pay redundancy to waterside workers. These borrowings were to be met by a levy charged to all port users. On 1 October 1990 the company repaid $845,000 on the loan and the levy ceased. The company treated this payment as a revenue payment and claimed a deduction which was disallowed. The repayment of the $845,000 was held to be an election by the company to make a lump sum repayment of money borrowed for redundancy, as opposed to allowing it to be paid off by port levies. The High Court had found the expenditure did not give rise to an enduring benefit and therefore
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the payment was not of a capital nature and was allowed as a deduction. The fact that the payment improved the company’s competitive advantage by eliminating the levy was incidental and did not change the essential character of the payment. In Commissioner of Inland Revenue v Lyttelton Port Co Ltd (1997) 18 NZTC 13,273 (CA), the Court of Appeal overturned the decision of the High Court in respect of the costs of demolishing buildings the Port Company was required under legislation to acquire certain buildings for which it did not have a use. It demolished the buildings and claimed a deduction for the demolition costs of $13,500. The High Court had allowed the deduction on the grounds that the costs were a necessary revenue item in the carrying on of the taxpayer’s business. However, the decision was overturned in the Court of Appeal applying the principles laid down in Mt Isa Mines Ltd. By demolishing the buildings, the taxpayer obtained a long-term benefit from the resulting improvement in the standard and extent of the wharf area. The benefit was found to be a capital asset. The costs of demolition were also found to be capital in nature.

In Commissioner of Inland Revenue v Commissioner of Inland Revenue (1997) 18 NZTC 13,487 (HC) a company, jointly owned by a chartered accountant in public practice and his largest client, borrowed $600,000 for investment purposes. The company subsequently lost most of the money, leaving $500,000 owing. Although not legally required to make good the company’s loss, the chartered accountant and his client each undertook to repay the amount owing by payments of $25,000 a year. The Court held that the payments by the chartered accountant were deductible for income tax purposes because they were “calculated from a practical and business point of view to secure his business reputation and so enhance his income earning”. Although the payments could be regarded as capital in nature because they were technically a loan to the company, the reality was that the debt could and would not be repaid. The Court’s conclusion was reinforced by the voluntary nature of the payments and the relationship of the chartered accountant with his largest client. See also Cox v Commissioner of Inland Revenue (1992) 14 NZTC 9,164 (HC).

In Hawke’s Bay Power Distribution Ltd v Commissioner of Inland Revenue (1999) 19 NZTC 15,226 (CA), expenditure by a power board to replace overhead power lines with underground cables was held to be capital in nature for the following reasons:

(a) The “final objective” of the power board was the replacement of existing overhead power lines with underground cables.

(b) The urban distribution system is an entirety by itself.

(c) Underground distribution systems and overhead distribution systems are fundamentally different in character — they are two separate and distinct asset categories.

(d) The scale and degree of the work involved in the replacement project and the money expended on it clearly indicates that the expenditure is capital in nature.

(e) Most of the expenditure incurred on the underground work was acknowledged by the power board to be capital in nature. It was artificial to try to dissect the work into capital and revenue categories.

(f) Substantially the whole of the urban residential distribution system was placed underground — the urban residential system is a new and different distribution system, not a repaired system.

A similar decision was reached in Poverty Bay Electric Power Board v Commissioner of Inland Revenue (1999) 19 NZTC 15,001 (CA) and Auckland Gas Co Ltd v Commissioner of Inland Revenue (2000) 19 NZTC 15,702 (PC).

When a business is sold, the subsequent payment by the purchaser of the accrued liabilities of the vendor are capital payments and are not normally deductible, even if they would have been deductible to the vendor. In Commissioner of Inland Revenue v New Zealand Forest Research Institute Ltd [2000] 3 NZLR 1, (2000) 19 NZTC 15,689 (PC), a company formed under the Crown Research Institutes Act 1992 took over the assets and liabilities of former Crown entities. The liabilities included accrued annual leave owing to employees of the former Crown entities at the date of incorporation. The Privy Council held that the payment of contingent liabilities attributable to a previous employer, and paid as part of the cost of acquiring a business, are not an allowable deduction. This overturned the earlier Court of Appeal decision of New Zealand Forest Research Institute Ltd v Commissioner of Inland Revenue (1999) 19 NZTC 15,211 (CA), that had held that the company’s subsequent payment of this accrued annual leave was deductible expenditure because the Crown
Research Institutes Act 1992 deemed the pre-transfer employment service to be provided to the transferee company on an unbroken basis.

Section DC 10 now governs the deductibility of accrued remuneration payable to employees who transfer to the new owner when a business is sold. However, the principles of the New Zealand Forest Research Institute case remain relevant in respect of other expenditure types.

In Jupiters Ltd v Deputy Commissioner of Taxation [2001] FCA 1869, the Full Federal Court of Australia found that a “special rent” of $7 million per annum over a 10 year period was capital in nature and non-deductible. Payment of the “special rent” obtained for the taxpayer the right to exclusively operate a casino for a 10-year period. The Court held that the payments were made to secure exclusivity and freedom from competition and, as such, provided an enduring benefit that would enhance the goodwill of the business. Hence the payments related to the profit-earning structure of the business and were on capital account.

In Fullers Bay of Islands Ltd v Commissioner of Inland Revenue (2006) 22 NZTC 19,716 (CA), legal costs incurred in an unsuccessful attempt to secure a service contract were held to be on capital account. The contract, if awarded, would have been a major addition to the structure and business of the appellant.

240.40 No deduction for expenditure or loss of a private or domestic nature [s DA 2(2)]

No deduction is allowed for expenditure or loss which is of a private or domestic nature. Expenditure required to remedy an injury or disability to the human body is expenditure of a private or domestic nature, even if the expenditure is to enable the taxpayer to resume earning income by having his or her health restored. Such expenditure is not incurred in the course of gaining or producing income, nor is it an overhead or functioning cost in a taxpayer’s business. Instead, it is a health maintenance cost for a taxpayer as a human being [see TIB vol 7:1 (July 1995)].

However, in Morris v Federal Commissioner of Taxation [2002] FCA 616, the Federal Court of Australia ruled in favour of 10 taxpayers who were claiming deductions for sunglasses, sunscreen and sunhats. The ATO has now accepted that outdoor workers, such as farmers, and builders, whose occupations require them to work in the sun, can claim these costs in the same way as they are able to claim the cost of protective clothing.

Guarantee payments made in relation to two clients’ debts by a taxpayer in business as an accountant were held to be private expenditure and not deductible when they were to protect the accountant’s reputation and maintain his relationship with the bank: TRA Case S44 (1995) 17 NZTC 7,301, (1995) 20 TRNZ 209.

240.45 No double deductions [s BD 4(5)]

If a particular expenditure or loss is deductible under more than one provision of the ITA, the total deduction cannot exceed the amount of the expenditure or loss. For example, in the purchase of trading stock a taxpayer cannot claim a deduction under both ss DA 1 and EB 1: BASF New Zealand Ltd v Commissioner of Inland Revenue (1996) 17 NZTC 12,549 (HC) and BASF New Zealand Ltd v Commissioner of Inland Revenue (1997) 18 NZTC 13,322 (CA).

240.50 Deductions not allowed for taxes and duties paid [s DB 1]

Unless specifically provided for, there is no deduction allowed for income tax or any civil penalty (as defined in s 3(1) of the TAA), criminal penalty, or interest imposed under the TAA 1994. Similarly, there is no deduction allowed for any foreign taxes, penalty, or interest imposed which is of a substantially similar nature to that which is imposed in New Zealand.

In this context, “income tax” also includes the qualifying company election tax, and foreign taxes imposed which are of substantially the same nature as income tax. It also includes any further income tax, imputation tax penalty tax, dividend withholding payment or further dividend withholding payment, or dividend withholding payment penalty tax. It includes any penalty by way of additional tax for late payment of any tax or similar payment.
Income tax, in this context, does not include fringe benefit tax (FBT) or the employer’s superannuation contribution tax (ESCT) [see 540.330].

**240.55 Deduction prohibited for bribes** [s DB 45]

No deduction is allowed for bribes paid to a public official to obtain retail business or obtain any improper advantage in the conduct of business. The prohibition applies to bribes paid within New Zealand and also outside of New Zealand if it is an offence under the laws of the foreign jurisdiction. However, the prohibition does not apply where the amount is paid for the primary purpose of ensuring or expediting the performance by a foreign public official of a routine government action and the amount paid is small.

**240.57 Fines and penalties**

Most fines and penalties are not deductible for tax purposes. In many cases, there is insufficient nexus with the income-earning process. In other cases, deductibility is denied on the grounds of public policy. The CIR has issued interpretation statement IS 09/01 which examines the deductibility of fines and penalties imposed under a statute or regulation. The statement does not apply to the following:

(a) Fines or penalties imposed under a contract or as a result of a commercial dispute;
(b) Penalties for late payment of an amount that is not itself payable in respect of a breach of statute or regulation;
(c) Legal fees incurred in defending a fine or penalty.

It is the view of the CIR that no tax deduction is available for any fine or penalty of a type covered by the statement irrespective of whether or not there is a nexus with the income earning process and irrespective of whether or not:

(a) The fine or penalty imposed forms part of criminal proceedings;
(b) The fine is imposed by the Court or another body;
(c) The fine is imposed on the taxpayer, the taxpayer’s employees or a third party;
(d) The taxpayer intended to break the law; or
(e) The fine is imposed for a strict liability offence.

The full text of the interpretation statement can be found in TIB vol 21:9 (December 2009), at 11-18.

**240.60 Companies in a group** [s DV 13]

Section DV 13 is the deduction side of a measure designed to ensure that no undue advantage accrues to groups of companies having their business operated through a number of different companies rather than through just one company. The income side of the measure is contained in s CV 1.

Section CV 1 notionally combines the activities of companies in a wholly-owned group in order to determine whether an item of income in one of the companies would be taxable if all of the activities of the group were conducted in one company. If the answer is that the item of income would be taxable under those circumstances, it is taxable to the company which derived it.

Section DV 13 ensures that a deduction is available on the same basis. If a deduction would have been allowed had the group operated through just one company, a deduction is available to the company which has derived the income under s CV 1.

**240.65 Deduction prohibited for loss of premises** [s DB 20]

Generally no deduction is allowed for a loss incurred on the demolition, destruction, or disposal of any building. This is because such a loss will generally be a loss of capital. The two exceptions to this rule are where:

(a) Had the premises instead been disposed of, the proceeds would have been income under s CB 1 (Amounts derived from business) or s CB 2 (Profit making undertaking or scheme) or ss CB 6 to CB 15 (Land sales); or
(b) The building is a temporary building [s DB 20].

“Temporary building” means any building which:

(a) Has been erected pursuant to a permit issued by a local authority or public authority subject to its demolition or removal at the pleasure of the local authority or public authority; or

(b) A building erected at a construction site, which is to be demolished or removed on or before the completion of the construction; or

(c) A building which was erected, and is used, for the purpose of housing specific plant or machinery, and will need to be demolished in order to remove or replace that plant or machinery.

In Commissioner of Inland Revenue v Lyttelton Port Co Ltd (1997) 18 NZTC 13,273 (CA), the Court of Appeal disallowed losses on the demolition and disposal of buildings and found the demolition costs to be capital in nature and therefore non-deductible. The case followed the reasoning of Mt Isa Mines Ltd v Federal Commissioner of Taxation 92 ATC 4,755 (HCA) [see 240.35]. The creation of a better asset (a greater area of uncluttered wharf) was an enduring benefit.

240.70 Employee benefits [ss DC 6, CX 31]

(1) Funds [s DC 6]

A deduction is allowable for any amount that an employer pays to, or sets aside as a fund to provide individual personal benefits to, employees. The fund must not be a superannuation scheme and the rights of the employees to receive the benefits must be fully secured.

(2) Income protection insurance [s CX 31]

Income protection insurance premiums paid by employers on behalf of their employees are deductible but not subject to fringe benefit tax provided that any claims under the policies are treated as assessable income of the employees.

240.75 Chatham Islands dues [s DB 4]

A deduction is allowed for dues levied under the Chatham Islands Council Act 1995 for any goods used by the taxpayer in connection with a business. The dues are not to be taken into account in calculating the cost of goods for the purpose of allowing any other deduction for those goods.

240.80 Costs of tax liability determination [s DB 3]

Any taxpayer (including taxpayers deriving salary and wages only) may claim a deduction for expenses incurred in connection with:

(a) The calculation or determination of the income of the taxpayer for any tax year;

(b) The calculation or determination of GST payable by the taxpayer for any taxable period;

(c) The preparation, institution, or presentation of an objection or challenge to, or an appeal against, any determination or assessment made under the ITA 2007, TAA 1994, or GSTA 1985;

(d) Any contribution by the taxpayer to the expenses of another taxpayer concerning the calculation or determination of that other taxpayer’s income or GST payable where the matter involved affects the determination of the taxpayer’s own income and the taxpayer has objected to or challenged or appealed against an assessment or determination.

The kinds of expenditure and costs allowable are legal fees, accountancy fees, expert or other witnesses’ fees, Court costs, and other expenses. The expenses must be directly related to the preparation, institution, and presentation of an objection or appeal against an assessment or determination, or in connection with the calculation or determination of the taxpayer’s income for tax year. It is not vital that a dispute actually reaches the Court or TRA. Expenditure incurred in obtaining specialist tax advice or a legal opinion before the matter is resolved one way or another is deductible. Only net costs and expenses are allowable. Any amount received by way of reimbursement or awarded by the Court is to be taken into account as income in the income year in which it is received. This avoids the necessity for adjusting previous years’ assessments.
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Section DB 3 further provides that no deduction is allowed in connection with:

(a) Any matter or assessment arising from a return of income which was fraudulent or wilfully misleading.

(b) Any offence under any of the tax legislation.

(c) Any assessment of penal tax, but such costs would be allowable if the taxpayer objects to the assessment on the grounds of not being chargeable with penal tax and wins the case. However, there would be no claim if the penal tax assessment was merely reduced.

(d) Any objection or appeal which, in the opinion of the CIR, is of an inconsequential or frivolous nature.

(e) Any GST assessment or matter if the taxable activity for GST purposes does not constitute a business for income tax purposes. Where the CIR refuses to allow a deduction, the taxpayer can challenge the assessment in the ordinary way, on the ground that the costs are properly deductible under the section.

A deduction was disallowed in TRA Case J8 (1987) 9 NZTC 1,048 on grounds that the company was a "shell" company with prior tax losses which in the year of deduction had not established itself to be in business.

A taxpayer’s loss of work time in attending tax dispute hearings is not deductible: TRA Case S75 (1996) 17 NZTC 7,469.

240.85 Misappropriation and theft by employees and contractors [s DB 42]

A deduction is allowed for any loss incurred by the taxpayer in the course of carrying on a business where the loss results from the misappropriation of any property by any person employed by, or rendering services to, the taxpayer for the purposes of the business. Examples of such losses may include stolen cash or cheques used to pay private expenses, and stolen trading stock or assets.

The loss is allowed as a deduction for the income year during which it is ascertained, or in such earlier years as the CIR considers fair.

Any amount recouped by the taxpayer on account of that loss, whether by way of insurance, indemnity, reimbursement, recovery, or otherwise, is deemed to be income derived by the taxpayer in the income year in which the amount was recouped [s CG 4].

No deduction is available under s DB 42 where the property is misappropriated by any person who is associated with the person who operates the business [see 70 ASSOCIATED PERSONS].

In Curtis v J & G Oldfield Ltd (1925) 9 TC 319 a debt owing by the principal shareholder to a company was held not to be deductible.

In Ash v Commissioner of Taxation (New South Wales) (1938) 61 CLR 263, (1938) 1 AITR 447 (HCA) at 273, 451, the Court observed that:

"... purloinings by office boys and thefts by shop employees should, prima facie, be allowed as deductions. They may be shown to be incidental to, and perhaps inevitable in, the operations which produce income. But the case is different when income is actually received and then misapplied by the proprietor of a business or a person in such a position as a proprietor, as, for example, the manager of a company."

In Bamford v ATA Advertising Ltd (1972) 48 TC 359, a company could not claim a deduction for an amount misappropriated by a director in charge of the financial affairs of the company.

In WG Evans & Co Ltd v Commissioner of Inland Revenue (1976) 2 NZTC 61,080, (1976) 1 TRNZ 358 (SC), a deduction was allowed to a company for funds embezzled by its accountant who was also a nominal shareholder.

In Gray v Penrhyn [1937] 3 All ER 468 (KB), it was held that, where auditors made good misappropriated amounts that their clerk, during inspection of the books, failed to discover, repayments to the client represented income to the client and should be offset against any deduction claimed for the loss.

In Charles Moore & Co (WA) Pty Ltd v Federal Commissioner of Taxation (1956) 95 CLR 344 (HCA), a deduction was allowed for the theft of a day’s takings while being taken to the bank by an employee.
In *Gold Band Services Ltd v Commissioner of Inland Revenue* [1961] NZLR 467 (SC), losses from the armed robbery of a service station were deductible.

In *TRA Case K39* (1988) 10 NZTC 336, (1988) 11 TRNZ 682, an allowance of 2.5 per cent for theft by milk deliverers and two per cent for other categories of cash loss was held to be reasonable in relation to a gross margin basis assessment of a milk vendor.

In *TRA Case K6* (1988) 10 NZTC 129, (1987) 11 TRNZ 373, the CIR made the taxpayer an annual allowance to cover theft. The TRA found that the fixed allowance was artificial and greater regard should have been given to the circumstances of the vendor’s business, particularly its fluctuating returns.

In *TRA Case N40* (1991) 13 NZTC 3,344, (1991) 15 TRNZ 935, a taxpayer could not obtain a deduction for lost money invested in a finance company which went into liquidation. Because the taxpayer’s business was not an investment business, the losses could not be counted as losses of trading stock or on revenue account. Nor could the finance company or its proprietor be said to be employed or engaged in service in the taxpayer’s business.

### 240.90 Theft and burglary losses

The CIR will consider losses by theft (other than by employees), where all of the following apply:

(a) It can be established that the loss was through a normal business hazard, such as unavoidable holding of cash on premises overnight and losses in transit;

(b) There is satisfactory corroborative evidence of the theft and the amount involved;

(c) The loss is not a loss of fixed capital assets; and

(d) The loss is not recoverable by insurance.

Capital losses, whether due to burglary or other causes, are not deductible. In *Calkin v Commissioner of Inland Revenue* (1984) 6 NZTC 61,781 (CA), funds were advanced to an agent for investment and were misappropriated. The taxpayer suffered a loss of capital and the losses were not deductible.

A landlord is not entitled to deduct the loss incurred as a result of personal effects stolen by a tenant. In *TRA Case G80* (1985) 7 NZTC 1,369, the taxpayer rented his own flat to tenants during a temporary absence overseas. Personal effects and clothing belonging to the landlord were stored on the premises. The tenants damaged and stole many of these items. The TRA held there was insufficient relationship between the loss and the taxpayer’s income earning process to claim a deduction for the loss.

Any insurance or compensation received for the loss of trading stock or other article, where the cost of the asset lost has been taken into account in calculating the income, is taxable.

### 240.95 Environmental expenditure [ss DB 46, CB 8]

#### (1) Expenditure incurred from 10 June 2005

The following rules apply to environmental expenditure incurred in any income year starting on or after 10 June 2005. For expenditure incurred before 10 June 2005 see *Staples Tax Guide* (2006) 240.95.

Four broad categories of environmental expenditure are included in s DB 46 and sch 19. These are:

(a) Testing and feasibility expenditure;

(b) Construction or improvement expenditure;

(c) Monitoring expenditure; and

(d) Restoration and remediying expenditure.

Subject to the conditions set out below being satisfied, expenditure falling under any of the above categories (except construction or improvement expenditure), are immediately deductible. Construction or improvement expenditure is required to be amortised over the lesser of 35 years and the length of the applicable resource consent. Where no resource consent is required for an item of expenditure, the amortisation period is 35 years. The percentage amortisation rate is, at the taxpayer’s option, either the straight line rate or the diminishing
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value rate, that is nearest to the calculated rate. Taxpayers are able to apply to the CIR for a different category-specific amortisation rate where appropriate.

Landfill cell construction expenditure is able to be amortised. The amortisation rate is, at the election of the taxpayer, either 63.5 per cent straight-line equivalent or 63.5 per cent diminishing value depreciation rate. The amortisation regime applies to cell construction costs by way of excavation, cell lining and leachate drainage [see Determination 05/02 in TIB vol 17:10 (December 2005) at 50].

To be eligible for the deductions, all of the following conditions must be satisfied:

(a) The taxpayer must carry on business in New Zealand;
(b) The expenditure must be incurred as part of the business, or as part of ending the business operations, of the taxpayer;
(c) The expenditure must be of a type listed in sch 19, Part A or Part B;
(d) The expenditure must not be of a type listed in sch 19, Part C (excluded expenditure) being land acquisition or reclamation and dredging which is not for the purpose of avoiding, remedying or mitigating the effects of a discharged contaminant;
(e) The expenditure must not be incurred in relation to property held on revenue account (unless subject to an election under s CB 8); and
(f) The expenditure must not be deductible or depreciable under any other section of the Act.

The remaining balance of any expenditure that is required to be amortised is able to be written-off for tax purposes where either the business operations for which the expenditure was incurred cease or the improvement is destroyed or rendered useless.

To prevent taxpayers from accelerating the amortisation rate by applying for a short-life resource consent and later applying to have its life extended, a clawback mechanism is contained in s CB 28. This section provides that, where a business has claimed a deduction based on the resource consent period, and the consent period is extended or renewed by more than 50 per cent, the taxpayer is required to recalculate the deductions using the 35-year rate. The difference between the deductions claimed to date and the deductions that would have been allowable had the 35-year rate been used is taxable income.

Special provisions for landfill operators are contained in s CB 8. This section grants landfill operators the ability to claim a deduction for the cost of land used as a landfill. In order to avail themselves of the provision, the taxpayer must file an election to treat the land as being on revenue account. An election must be filed in respect of all landfill sites of both the taxpayer and any associated person of the taxpayer. The elections must be filed by 24 June 2006 or 12 months after the date on which the person acquires the land, whichever is later. Further conditions, all of which must be satisfied are as follows:

(a) The land is used as a landfill prior to disposal;
(b) The land is not being used as a landfill at the time of disposal; and
(c) The land is not disposed of to a person who is an associated person under subpart YB [see 70.20].

Where the conditions are satisfied, s CB 8 provides that the proceeds (if any) of the sale are income. Accordingly, the cost of the land is deductible. Examples of the operation of the environmental expenditure regime are contained in TIB vol 17:7 (September 2005) at 23-28.

240.97 Environmental restoration accounts [ss CB 28, CX 52, DQ 4, EK 1 to EK 23]

It is often the case that environmental restoration expenditure results in tax losses that are not able to be used because the underlying business operations of the taxpayer have ceased. In response to this problem, an environmental restoration account scheme has been introduced. Under the scheme, taxpayers are able to make deposits into an Environmental Restoration Funds Account which is held by the CIR in the taxpayer’s name. A deduction is allowed in respect of the deposit with the amount of the deduction being calculated by dividing the amount of the deposit by the highest rate of income tax which could apply to the business. This results in the deposit being entirely funded by the reduction in tax.
Example 1:
XYZ Ltd makes a deposit of $10,000. The allowable deduction is $35,714 ($10,000 / 28%).

(1) Eligibility
The eligibility requirements are contained in s EK 2. In order to be eligible to make a deposit under the scheme, the taxpayer must be carrying on a business in New Zealand and expect to incur in a later income year expenditure for the purposes of avoiding, remedying or mitigating detrimental effects of discharge of a contaminant. The expenditure must not relate to:
(a) Land reclamation or acquisition (other than under an election made under s CB 8 [see 240.95]); or
(b) Dredging, other than dredging for the principle purpose of remedying or mitigating detrimental effects on the environment from a discharged contaminant.

The expected expenditure must be provided for by way of a provision in the taxpayer’s audited financial statements. The minimum deposit is $1,000 [s EK 3]. The maximum deposit is the lesser of:
(a) The amount by which the “maximum account balance” exceeds the balance in their ERA account at the end of the income year; and
(b) The amount permitted under the initial five year spreading mechanism.

The “maximum account balance” for an eligible taxpayer is calculated by multiplying the level of the accounting restoration provision by the applicable tax rate. An initial five-year spreading mechanism applies to limit the fiscal effect of allowing deposits to be made for historic restoration liabilities.

(2) Payments and Transfers
Payments into the account may be made during the income year and up to six months following the income year. Payments after this period can be accepted at the discretion of the CIR. The following information must be provided within two working days of the payment:
(a) Name of the taxpayer;
(b) Income year for which the deposit is made;
(c) A calculation of the business’s maximum payment; and
(d) Any additional information required by the CIR.

The CIR has the ability to require that the information be provided in electronic format. An automatic refund will be made if the required information is not supplied or the payment exceeds the business’s maximum payment amount.

Amounts held in an ERA can be transferred to any of the following:
(a) The ERA of another business provided that the associated environmental obligations have also been transferred and that other business would be entitled to make an equivalent ERA payment;
(b) The department responsible for the administration of the Environment Act 1986; or
(c) The ERA of an amalgamated company.

Any application must be made in writing, state the grounds on which the application is made; and state the amount to be transferred.

The transferee is able to take a deduction for the grossed-up amount of the transfer while the transferor is deemed to have derived income of the grossed-up amount. Any non-qualifying amount will be returned to the transferor.

Compulsory transfers occur on the death, bankruptcy or liquidation of the taxpayer. If the administrator of a person’s estate, the Official Assignee, or the person’s liquidator, notifies the CIR that the obligation associated with an ERA deposit has been transferred to another person, the ERA balance will be transferred to that person and will be treated as a payment by that person into their environmental account. Where a company ceases to exist on an amalgamation, any ERA account balance is transferred to the amalgamated company. The minimum transfer is the lesser of $1,000 and the balance of the account.
In a consolidated group, the nominated company makes the payments and receives the refunds on behalf of the group.

(3) Refunds

Refunds are able to be made where the taxpayer has incurred monitoring or restoration expenditure that is not listed in sch 19, Part C. The expenditure must be incurred after the date on which the ERA is first established. It must not be less than the amount calculated by dividing the amount of the requested refund by the applicable tax rate. Any refund request must be made in writing, state the grounds for the refund and provide evidence to support those grounds. The CIR can make automatic refunds where a person’s ERA balance exceeds their maximum account balance.

Interest at the rate of three per cent per annum is paid on ERA balances. The interest is not added to the account balance but, rather, is paid out on the earlier of 31 March each year or the date on which the relevant payment is refunded or transferred.

For examples see TES 28 (July 2005) 429, 430, 431, 432.

240.100 Payments between spouses [ss DB 57, DC 5]

A deduction is not allowed for payments by a taxpayer to their spouse [see 960.10], unless the following conditions are met:

(a) The CIR’s consent is obtained before a deduction is claimed;
(b) The CIR is satisfied that the payment is for services rendered or is otherwise a bona fide payment;
(c) The services are not domestic services or services performed in connection with the home; and
(d) The payment was exclusively incurred in the derivation of assessable income.

Any deduction for a payment by a taxpayer to their spouse is subject to the restrictions in s GB 23.

Thus, the CIR’s prior approval is required before claiming a deduction for salary or wages paid by one spouse to the other. The payment of any increase in the salary also requires the CIR’s prior approval.

It is a condition of the allowance that the taxpayer first establishes with the CIR that the payment is genuine and at an arm’s length rate having regard to the skills and responsibilities provided. A deduction is not permitted for domestic services or services in connection with the home performed by the spouse, except that a deduction is allowable for wages paid by a farmer to the spouse for cooking for farm employees.

Example:

A claim may be made for wages paid to a spouse who keeps the books of the business at home, to the spouse of a doctor who acts as a receptionist at the home, or who answers the telephone at home.

The following procedures are necessary:

(a) The Act specifically provides that “payment” must be made. The mere crediting of an account in the name of the spouse is not sufficient. However, in certain cases, a crediting in account is equivalent to payment and, provided the following conditions are satisfied, the deduction is allowed:

(i) The spouse has control over amounts received;
(ii) The spouse agrees to the amounts received being used in a certain way;
(iii) The application letter is in order;
(iv) A statement of how amounts received by the spouse are to be used is signed by the recipient and sent in with the taxpayer’s application.

(b) The payment must be a reasonable sum for the services rendered, having regard to the current level of wages payable to an employee at arm’s length. There must be no element of gift in the payment.

(c) The recipient spouse must have an IRD number, complete the necessary tax code declaration, and have PAYE deducted in the same way as any other employee.

(d) Where the payment is not for services but is a bona fide payment of rent or interest and there is no question as to the source of the assets of the spouse and the payment is reasonable, a deduction may
be allowed without the necessity for prior approval. However, this is not a strict application of the section.

Application for approval must be supported by a statement or simple declaration signed by the taxpayer or agent setting out:

(a) The nature of the business in which the spouse is employed. If it is a farming business, the particular type of farming and, where it is dairying, the number of cows milked. This is material for the purpose of determining the amount of labour necessary. Standard share-milking agreements specify the number of milkers according to the number of cows, and this will be regarded as setting a reasonable standard.

(b) Precise and full details of duties carried out by the spouse.

(c) Number of hours worked by the spouse during the average week, and the number of weeks to be worked during the year.

(d) Particulars of other labour employed and amount paid as wages, apart from wages paid to the spouse.

(e) Mode of payments of wages to the spouse, eg in cash at regular intervals, periodically, or by crediting an account.

(f) Amount of wages paid to the spouse.

(g) The scope and extent of domestic duties carried out by the spouse in addition to the duties relating to the business.

240.105 **Bursaries for employees**

Bursaries and similar payments offered by employers to attract staff are deductible to the employer, being expenditure “incurred in carrying on a business”. The expenditure is deductible whether paid to or on behalf of an existing employee or for a prospective employee on condition that he or she stays with the employer for a specified time (whether or not a formal deed is completed).

240.110 **Office expenses**

Office expenses may be deductible for income tax purposes on the ground that they are incurred in the derivation of assessable or excluded income. However, where the only source of income is interest and dividends, the investments of themselves do not make the use of an office essential. Office expenses incurred in deriving this type of income are in the nature of voluntary expenses rather than amounts necessary for the production of income and are therefore not deductible. The interest and dividends will be received whether there is an office or not: *Commissioner of Inland Revenue v Banks* [1978] 2 NZLR 472, (1978) 3 NZTC 61,236, (1978) 2 TRNZ 323 (CA).

240.115 **Business relocation expenses**

The following costs are likely to be incurred when a business relocates:

(a) Physical relocation of employees, trading stock and plant.

(b) Disposal costs associated with old premises.

(c) Acquisition costs associated with new premises.

The CIR has issued Interpretation Statement IS 10/06 setting out the CIR’s opinion regarding the deductibility of items included in the first of these three categories. These costs are likely to include:

(a) Packing and unpacking.

(b) Freight.

(c) Temporary storage.

(d) Insurance specifically related to the move.

(e) Hire of forklifts, containers and other machines specifically for the purpose of the move.

(f) Labour (either employees or contractors) to dismantle, move and reassemble items.
(g) Relocation costs for employees such as physical moving of chattels and temporary accommodation. The Interpretation Statement does not consider the deductibility of costs associated with vacating the old premises such as lease termination payments. Neither does it consider the cost of readying the new premises for occupation.

The Statement concludes that the deductibility or otherwise of the costs is governed by the reason for which the expenditure was incurred. If the relocation is undertaken to enable the business to carry on as usual from a new location, the expenditure will be deductible. This will be the case whether or not the business is growing and requires larger premises to accommodate the growth. If, on the other hand, the relocation is undertaken as part of a plan that changes the structure of the business to enable it to operate in a different way, the relocation expenses will be capital in nature and not deductible. An example would be where the business is expanding the product range that it produces and requires larger premises to accommodate the new plant and equipment.

The full text of the Statement, including examples, can be found in TIB vol 22:8 (September 2010) at 20-38. The Statement takes effect from the beginning of the 2010-2011 income year.

The costs of moving a building are capital and are capitalised to the buildings account. If the original installation costs have been capitalised and depreciation written-off and allowed for tax purposes, any loss is capital and no further allowance can be made where the buildings are removed, or have been demolished or abandoned.

240.120 Outward Bound course fees for employee

The fee paid by an employer to the Outward Bound Trust for an employee sponsored by the employer is treated as part of staff training expenditure and therefore becomes an allowable deduction to the employer. However, any fee paid to the Trust for a person who is not an employee cannot be an allowable deduction under this rule [see TIB vol 4:5 (December 1992) at 43].

240.125 Cost of ceremonies for new buildings

There are three stages in the erection of a new building which are customarily made the occasion for some form of ceremony:

(a) The cost of “laying the foundation stone” and “topping off” ceremonies should be capitalised to the building account and depreciated; and

(b) The opening day expenses including cost of entertainment, scaffolding, seating, the printing of special brochures, and labour may be claimed as a deduction. However, the allowable deduction for entertainment expenditure may be limited to 50 per cent of that expenditure [see 350 ENTERTAINMENT EXPENDITURE and TIB vol 6:9 (February 1995) at 18].

240.130 Fidelity fund levies

Levies imposed by the New Zealand Law Society fidelity fund are allowable deductions. These deductions are allocated to the income year in which the levy is incurred. This is regardless of whether payment is made in one sum or by instalments over a number of income years. The levies are neither fines nor penalties on individual practitioners. Each practising member is liable to make payment by virtue of being a practising member. The payments are a prerequisite for obtaining a practising certificate for a solicitor and so lack the voluntary nature of a gift or donation [see TIB vol 4:7 (March 1993) at 1].

240.135 Telephone and toll charges

Business telephone and toll charges are deductible. When the telephone is installed in a private residence, deductibility may be limited. A deduction for any expenditure or loss to the extent to which it is of a private or domestic nature is not permitted. A telephone installed in a private home need not be registered as a business telephone in order for the rental to be deductible. The extent to which it is used for business purposes is a question of fact and, if there is significant private use, an apportionment of the rental should be made and only the business portion claimed.
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Inland Revenue sets a standard apportionment of 50 per cent of telephone rental being business related and 50 per cent being private for commercial or domestic telephones installed in residences. If a commercial line is installed in addition to a domestic line, 100 per cent of the commercial line may be claimed. All of the telephone rental for farmers may be claimed as a business expense. The account for tolls should be analysed between business and private calls, and the latter excluded from the claim. In situations when a different apportionment of the rental better reflects the factual situation, the 50-50 apportionment may not be adhered to by Inland Revenue.

In *TRA Case H107* (1986) 8 NZTC 712, the taxpayer was employed by a Catchment Authority. On employing the taxpayer, the Catchment Authority had arranged to list his private telephone number under the Catchment Authority’s entry as an after-hours number. The TRA allowed a deduction of additional charges incurred for extra private listing by the employee.

Where the employee is liable for payment of the telephone account and the employer reimburses the employee for, or otherwise pays, the employee’s home telephone costs, the payment is employee remuneration and the employer must deduct PAYE. The employer is not liable for FBT on the payment. Where Inland Revenue is satisfied that all or part of the reimbursement or payment by the employer is justified for business purposes, that part is not income of the employee and not subject to tax.

Where the employer is liable for the telephone account, the payment of the rental and toll accounts is a fringe benefit. Any amount that cannot be justified as an exempt allowance is subject to FBT. In this situation, the employee is not liable for income tax on any amount that the employer pays [see TIB vol 4:8 (April 1993) at 4].

For a telephone to be neither subject to income tax in the hands of the employee nor FBT in the hands of the employer, Inland Revenue must be satisfied that the reimbursements or payments are justified. This is a question of fact and consideration is given to the type of business that the employer is running, the seniority and responsibilities of the employee, and the extent to which the phone is used for business purposes outside normal office hours. The employer must keep a schedule of employees who receive telephone rental reimbursements or payments. Information should include:

(a) The employee’s name and address;
(b) The amount of employer contribution to telephone cost; and
(c) A statement of the employment related use of the telephone.

240.140 Daycare facilities [TAA, s 91AA]

Businesses providing daycare facilities may deduct the normal “revenue” items associated with providing the daycare service. Capital costs incurred in construction of the facility would be treated in the normal way for capital expenditure. Where a taxpayer provides such services in their own home, the taxpayer is entitled to use actual costs for the purposes of determining deductible expenses, or alternatively to use standard costs determined by the CIR.

The CIR has issued determination DET 09/02: *Standard-Cost Household Services for Childcare Providers* which sets out the costs that may be deducted under the standard cost basis [see TIB vol 21:4 (June 2009) at 10]. Determination DET 09/02 applies to the 2010 and later income years. It remains in force until it is replaced, but is adjusted annually as at 31 March to take into account movements in the Consumer Price Index (CPI).

In order to use DET 09/02 the:

(a) Taxpayer must be a natural person who is not registered for GST; and
(b) Childcare service must be carried on in the taxpayer’s home and involve activities that normally occur in a family household.

Childcare must be provided in accordance with either:

(a) The Education (Home-Based Care) Order 1992; or
(b) The Licensing Criteria for Home-based Education and Care Services 2008.
Where applicable, GST is included in the costs provided in DET 09/02.

Taxpayers have the option of using the determination or, alternatively, deducting actual costs incurred. The election is made on a year-by-year basis. Where the determination is used, no costs other than those set out in the determination are able to be deducted. If taking a deduction for the costs set out in the determination results in a loss, the loss is unable to be offset against other income and is not available for carry forward to a future income year.

The standard costs that may be deducted are broken down into variable costs and fixed costs.

(1) **Variable standard cost**

The variable standard cost for the 2010-2011 income year is $3.29 per hour per child [see TIB vol 23:5 (June 2011) at 9]. This covers the costs of electricity, fuel, food, wear and tear, outings and associated transport costs, laundry, educational resources, modification costs, equipment, and first aid.

(2) **Fixed standard costs**

The fixed standard costs are calculated on an annual basis and do not vary according to the number of children cared for. The fixed standard costs are broken down into two parts:

(a) Administration and record keeping of $321 per annum for the 2010-2011 income year. This covers the cost of telephone usage, postage and stationery, computers, and other incidental administration costs; and

(b) Fixed standard domestic accommodation cost. The amount of the accommodation cost depends on whether the childcare provider owns or rents the home.

Where the provider owns the home, the fixed standard domestic accommodation cost is determined by way of the following formula which includes a reduction for any accommodation supplement received:

\[ ((a \times 5\%) - b) \times 50\% \times 33.33\% \]

Where:

- \( a \) = the purchase price of the property.
- \( b \) = the annualised amount of any accommodation supplement received (ie the weekly accommodation supplement \( \times 52 \)).
- \( 5\% \) = the cost of owning a domestic property including depreciation, rates, insurance, mortgage interest, etc.
- \( 50\% \) = the percentage of use of the house area as per the Order in Council. This covers use of all indoor and outdoor areas.
- \( 33.33\% \) = the availability factor based on 55 hours per week (7.30 am to 5.30 pm Monday to Friday, and 7.30 am to 12.30 pm Saturdays and Sundays).

Where the provider rents the home, the fixed standard domestic accommodation cost is determined by way of the following formula which includes a reduction for any accommodation supplement received:

\[ (a - b) \times 50\% \times 33.33\% \]

Where:

- \( a \) = the annualised rental payment (ie weekly rent \( \times 52 \)).
- \( b \) = the annualised amount of any accommodation supplement received (ie the weekly accommodation supplement \( \times 52 \)).
- \( 50\% \) = the percentage of use of the house area as per the Order in Council. This covers use of all indoor and outdoor areas.
- \( 33.33\% \) = the availability factor based on 55 hours per week (7.30 am to 5.30 pm Monday to Friday, and 7.30 am to 12.30 pm Saturdays and Sundays).
(3) Miscellaneous issues

The allowable variable standard cost and fixed record-keeping standard cost will be increased in line with the All Group Consumers Price Index as at 31 March of each year.

The purchase price of a domestic property includes any improvements made to it. Taxpayers will need to keep a record of any improvements and their cost.

Where the taxpayer incurs costs not included in the CIR’s determination, the costs may be claimed in addition to the standard costs. Adequate records must be kept. The example given in the commentary to the determination is the cost of complying with the training requirements of the Education (Home-Based Care) Order 1992.

Where specific costs are reimbursed by the guardian (for example the admission fee to a venue for an outing) the reimbursement amount is not taxable and the cost is not allowable as a deduction.

Where the standard cost deduction results in a zero income tax liability, the childcare provider is not required to file a return of income provided that the person had no other income from which tax has not been deducted at source.

Example 1:
Mary owns her own home and cares for two children from 7.30 am to 5.30 pm Monday to Friday and from 8.00 am to 12 noon on Saturdays (54 hours per week). She owns her own home which cost $250,000, and receives $50 per week accommodation supplement.

The standard cost deduction to which Mary is entitled is calculated as follows:
(a) Variable standard cost of $3.29 per child per hour:
$$3.29 \times 2 \times 54 = $355.32 \text{ per week} = $18,476.64 \text{ per annum.}$$
(b) Fixed administration cost: $321.00 per annum.
(c) Fixed accommodation cost:
$$((\text{cost of home} \times 5\%) - \text{accommodation supplement}) \times 50\% \times 33.33\% = \left((250,000 \times 5\%) - (50 \times 52)\right) \times 50\% \times 33.33\% = \left((12,500 - 2,600)\right) \times 50\% \times 33.33\% = $9,900 \times 50\% \times 33.33\% = $1,649.83 \text{ per annum}.$$

If Mary cares for the children for the full 52 weeks of the year, her annual standard cost deduction will be $18,476.64 + $321.00 + $1,649.83 = $20,447.47.

Example 2:
Mary rents her home at a rental of $250 per week. The deduction would be as follows:
(a) Variable standard cost of $3.29 per child per hour:
$$3.29 \times 2 \times 54 = $355.32 \text{ per week} = $18,476.64 \text{ per annum}.$$
(b) Fixed administration cost: $321 per annum.
(c) Fixed accommodation cost:
$$((\text{annualised rental} - \text{accommodation supplement}) \times 50\% \times 33.33\% = \left((250 \times 52) - (50 \times 52)\right) \times 50\% \times 33.33\% = \left((13,000 - 2,600)\right) \times 50\% \times 33.33\% = $10,400 \times 50\% \times 33.33\% = $1,733.16 \text{ per annum}.$$

If Mary cares for the children for the full 52 weeks of the year, her annual standard cost deduction will be $18,476.64 + $321.00 + $1,733.16 = $20,530.80.

(4) Presbyterian Support (Upper South Island) Homeshare programme

Determination DET 09/01: Standard-Cost Household Service for Homeshare Care Providers provides a similar standard-cost scheme for services provided by homeshare providers via the Presbyterian Support (Upper South Island) Homeshare programme which operates in the mid-Canterbury area. The programme
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involves the provision of a day activity programme for older people [see TIB vol 21:3 (May 2009) at 15-19].

240.143 **Boarding service providers** [TAA, s 91AA]

Natural persons providing private boarding services may deduct the normal “revenue” items associated with providing the boarding service. Capital costs incurred in construction of the facility would be treated in the normal way for capital expenditure. Where a taxpayer provides such services in their own home, the taxpayer is entitled to use actual costs for the purposes of determining deductible expenses, or alternatively to use standard costs determined by the CIR.

The CIR has issued determination DET 05/03: *Standard-Cost Household Service for Boarding Service Providers* which sets out the costs that may be deducted under the standard cost basis [see TIB vol 17:10 (December 2005) at 54-64]. In order to use the determination the:

(a) Taxpayer must be a natural person who is not registered for GST;
(b) Boarding service must be carried on in the taxpayer’s home. It can involve services that normally occur in a family household such as meals, laundry, and utilities;
(c) Boarding service provider must not have on average five or more boarders in residence during the income year; and
(d) Service must not be accommodation as an extension of any specialised healthcare or institutional halfway house to facilitate rehabilitation.

Where standard costs are used, any resulting loss is unable to be offset against other income and is not able to be carried forward. Taxpayers make the election by adopting the method in calculating their income. Taxpayers are able to choose between the two methods on a year-by-year basis. The standard costs that may be deducted are broken down into the weekly standard cost and annual capital standard cost.

1) **Weekly standard cost**

The weekly standard cost for the 2010-2011 income year is $243 per week for each of one or two boarders and $198 per week for the third and subsequent boarders [see TIB vol 23:5 (June 2011) at 9]. This component covers expenditure on items and services typically provided to boarders, such as food, laundry, cleaning, heating, power, transport, telephone rental, use of bedroom chattels, general household furniture, linen and incidentals. The amounts are retrospectively adjusted for each income year once the “Consumer Price Index” (CPI) movement for the 12 months to March is known.

Where a taxpayer elects to use this method and the weekly payments for the relevant number of boarders in any week do not exceed the standard-cost amount, the income is exempt.

2) **Annual capital standard-cost**

The annual capital standard-cost element represents the cost for the use of the domestic accommodation in providing the private boarding service and includes financing and depreciation costs. This is an annual calculation for the use of the domestic accommodation, based on:

(a) The actual cost to the boarding service provider of acquiring and making capital improvements to the domestic accommodation or renting the domestic accommodation in which the boarding services are provided;
(b) The proportion of boarders who reside in the accommodation in relation to the overall average number of occupants, and
(c) The proportion of the actual period during which private boarding services are provided in an income year.

The annual capital cost calculated must be reduced by the amount of any accommodation supplement received by a boarding service provider.
(3) **Boarding service provider who owns their domestic accommodation**

Where a boarding service provider owns their domestic accommodation, the annual capital standard-cost for any income year must be determined in accordance with the following formula:

\[ \left( (a \times 5\%) - b \right) \times c \times d \]

Where:
- **5%** represents the typical expenditure incurred in owning a domestic property, including depreciation of the building and outgoings such as rates, insurance, mortgage interest cost, repairs and maintenance;
- **a** is the purchase price of the domestic accommodation plus the cost of all capital additions;
- **b** is the annualised amount of accommodation supplement received by the boarding service provider (weekly amount received multiplied by 52 weeks);
- **c** is the average percentage of boarders in relation to the overall average number of occupants living in the domestic accommodation during the income year;
- **d** is the number of full weeks during which private boarding services were provided in an income year, divided by 52.

(4) **Boarding service provider who rents their domestic accommodation**

Where the boarding service provider rents their domestic accommodation, the annual capital standard-cost for any income year must be determined in accordance with the following formula:

\[ (a - b) \times c \times d \]

Where:
- **a** is the annualised rental payment (weekly rent paid × 52 weeks);
- **b** is the annualised amount of accommodation supplement received by the boarding service provider (weekly amount received × 52 weeks);
- **c** is the average percentage of boarders in relation to the overall average number of occupants living in the domestic accommodation during the income year;
- **d** is the number of full weeks during which private boarding services were provided in an income year, divided by 52.

The standard-cost for boarding service providers is calculated inclusive of GST (if any).

**240.145 Asset valuation fees** [s DB 5]

A deduction is allowed for expenditure incurred on obtaining a valuation of assets where the valuation relates to borrowing money that is used in deriving assessable and/or excluded income.

The cost of an asset valuation undertaken to enter into a policy of insurance is not deductible, although the premiums payable in respect of such policy may be allowed as a deduction. However, if the policy provides for an annual valuation of the assets covered by the policy, the annual costs of valuation are deductible.

**240.150 Expenditure on diploma course non-deductible**

The TRA has held that expenditure incurred on a diploma course by an architect prior to the establishment of his business is non-deductible. The taxpayer undertook the course to enhance his prospects of becoming a self-employed architect: *TRA Case Q18* (1993) 15 NZTC 5,100.

**240.155 Financial investment advice**

Expenditure paid to a financial and property management company to find and manage a suitable realty investment was apportionable between non-deductible capital expenditure and deductible revenue expenditure: *TRA Case R21* (1994) 16 NZTC 6,102.

Expenditure paid to a financial adviser for investment portfolio management services is deductible as it is part of an income earning process: *Commissioner of Inland Revenue v North* (1999) 19 NZTC 15,219 (HC). However, a deduction is not allowed for expenditure paid to financial advisers in relation to the
commencement of a new or significantly changed investment structure or strategy because such expenditure is not incurred in the income earning process: TRA Case T64 (1998) 18 NZTC 8,493; TRA Case U12 (1999) 19 NZTC 9,140.

240.160 Brokerage
Brokerage, being a cost of arranging an investment, or acquiring shares or investments, is not allowable as a deduction except in the case of:

(a) A person whose business consists of or includes dealing in shares and investments;
(b) A single venture, where the whole of the expenses are of a revenue nature; and
(c) Shares or investments that are revenue account property. For example, in Commissioner of Inland Revenue v Inglis (1992) 14 NZTC 9,180 (CA) and Commissioner of Inland Revenue v Stockwell (1992) 14 NZTC 9,190 (CA), the costs of shares were treated as an allowable deduction in determining the tax loss or profit from sales of shares. The decision of the Court in these two cases has been legislated in s DB 23 (cost of revenue account property).

240.165 Goods forfeited by law
In Nicholas Nathan Ltd v Commissioner of Inland Revenue (1989) 11 NZTC 6,213 (HC), goods forfeited by law by an importing company as a consequence of illegal importation were held to have been acquired for the purpose of resale and profit. Accordingly, their cost of acquisition (excluding fines and other penalties) was an allowable deduction.

240.170 Doctors
If fees are returned on a cash basis, a doctor is not allowed a deduction for a bad debt. The cash basis is considered to be an appropriate tax accounting practice for professional taxpayers who earn income as a direct result of their personal exertions, and do not have large levels of stock or accounts receivable, or use employees or assets in a significant way to generate their income: Federal Commissioner of Taxation v Firstenberg (1976) 6 ATR 297, 76 ATC 4,141 (VSC) and Federal Commissioner of Taxation v Dunn (1989) 20 ATR 356, 89 ATC 4,141 (FCA).

The following deductions may be relevant to medical practitioners in private practice:

(a) A doctor was allowed a deduction for part of the expenses of keeping and maintaining a guard dog to safeguard medical drugs and supplies as there was a sufficient relationship between the expenditure incurred and the gaining of income: TRA Case F24 (1983) 6 NZTC 59,671.
(b) The initial costs and additions for both libraries and instruments are not deductible but replacements may be claimed subject to the rules for low value asset write off [see 250 DEPRECIATION].
(c) Fines imposed on a doctor by the Medical Practitioners’ Disciplinary Committee or the New Zealand Medical Council are not deductible.
(d) Legal costs incurred by a professional person in resisting suspension from practice were held to be deductible: No 166 v Minister of National Revenue (1954) 10 Tax ABC 285.
(e) Claims for part of the outgoings on private residences can be made on a factual basis for surgery or rooms at the house specifically set aside and in fact used for the practice, or rooms that while not specifically set aside are used wholly or principally in the practice and to attend to patients. The allowable deductions are based on the proportion that the area of the room or rooms set aside and/or used in the practice bears to the total living area of the home. Expenditure subject to the apportionment would be rates, interest, insurance, heat and power, depreciation, and repairs and maintenance as far as they relate to the house generally (eg painting and repairing the exterior of the house). As far as the interior is concerned, generally repairs and maintenance relating to the surgery or rooms themselves and to the furniture and equipment in those rooms is fully deductible.
240.175 **Accrued holiday pay** [s EA 4]

The CIR interprets “holiday pay” as payment for holidays being the employee’s minimum entitlement under the Holidays Act 2003, and any payment for holidays provided for in an employment contract that are of a similar nature. Holidays are of two kinds: statutory holidays and annual leave.

The Holidays Act 2003 covers statutory holidays, namely: Anniversary Day, Christmas Day, Boxing Day, New Year’s Day, 2 January, Labour Day, Waitangi Day, Good Friday and Easter Monday, Anzac Day, and Queen’s Birthday Observance. The Holidays Act 2003 provides for a minimum of three weeks’ annual leave, or holiday leave provided for in an employment contract of a similar nature. If an industry or company provides for a certain day as a holiday (e.g., accountants’ or lawyers’ holiday, bank holiday, or company anniversary), payment for this day is also included as holiday pay.

Holiday pay does not include long service leave, retirement leave, sick leave, or any other accruing employee remuneration.

Once the amount of the liability for outstanding holiday pay is calculated, the employer must determine the amount of the unexpired expenditure portion of that liability. The unexpired portion is added back as income. This effectively means that the employer takes a deduction for the amount of any holiday pay incurred in the income year only to the extent that it has been taken and paid, or paid out in lieu of leave, either in that income year or within 63 days following the end of that income year.

The calculation of the unexpired expenditure for shareholder-employees takes into account amounts that are paid to the shareholder-employee before 31 March (i.e., the last day the company can have an extension of time for filing its tax return). This effectively means that the company takes a deduction for any shareholder-employee holiday pay incurred in the income year only to the extent that it has been taken (paid out) in that income year or before the relevant 31 March.

The practical effect of s EA 4 is that, while an employer may have incurred expenditure on account of holiday pay, the allocation of the allowable deduction is delayed until such time as payments for the holiday leave are made to the employee. The legislation does not specify what ordering system should be used for accrued holiday pay in cases where “stocks” of accrued holiday pay for which companies have previously been allowed a deduction exist. However, in accordance with the principle from *Clayton’s case; Devaynes v Noble* [1814-1823] All ER Rep 1, the crediting of holidays taken against holiday leave entitlements may be deemed to be paid out on a first-in first-out basis. An employer must use up the existing “stocks” for an employee before leave can be credited against newly accruing leave entitlements. The same first-in first-out rules apply to all accruals of employee remuneration.

240.180 **Accrued holiday pay on sale of business** [ss DC 10, CB 31, EA 4]

The deductibility of provisions for accrued wages and holiday pay, where employees transfer to the new owner on the sale of a business, depends on whether the vendor and the purchaser are associated persons.

Where the vendor and purchaser are not associated persons, the vendor is allowed a deduction for all provisions of employee remuneration where that liability is transferred to the purchaser. The deduction is allowed at the time of sale.

Where the vendor and the purchaser are associated persons, it is the purchaser of the business who is allowed the deduction for any liability transferred to it, provided that the amount would have been deductible to the vendor. The amount is treated as remaining unpaid by the purchaser, and subject to the prepayments rules, until such time as the purchaser physically pays the employees. For this purpose, the purchaser is permitted to account for the contingent and actual employee remuneration either on an employee by employee basis or on a group of employees basis, provided that the treatment is the same in each income year.

In either case, where the provisions for actual or contingent employee remuneration are less than the amount actually paid to the employees by the purchaser, the excess is treated as income of the purchaser at the time at which generally accepted accounting practice recognises the provision as being reduced.
240.185 Employee transfers [s DC 11]

Where employees are transferred to an associated person other than on the sale of the business, the associated person may deduct the amount of actual and contingent employee remuneration in respect of those employees, provided that the amount would have been deductible had the employees not transferred. For example, this would apply where employees are transferred to another company within a group of companies.

240.190 Directors’ fees

Generally, directors’ fees are deductible by the company. In the case of private companies where the directors are the principal or only shareholders, and so are in a position to determine their own remuneration, the question arises as to whether the sums voted as directors’ fees are what they purport to be, or are wholly or partly a distribution of profits. In the latter case, the CIR may reallocate the remuneration as a dividend.

In a private company when fees, salaries, and/or bonuses are voted to directors after the close of the accounting year, the question arises as to whether the amounts voted are deductible by the company in the year in which the remuneration was earned or the year in which they were voted. This question was discussed in TRA Case D3 (1979) 4 NZTC 60,424, (1979) 3 TRNZ 127, where, for some years before its accounting year ended 31 August 1975, the private company concerned had transferred its after-tax profit each year to its appropriation account in order to pay dividends to its shareholders. However, halfway through the accounting year, a budget was prepared which revealed the possibility that the accounts for the full year would disclose a loss. Economies were made, with the result that, when the accounts were completed after the close of the year, a profit was shown. The company decided, for the first time, to pay additional salaries to two of its directors, which it claimed as a tax deduction in its 1975 tax return. However, the CIR disallowed the deduction on the ground that, for the 1975 income year, the company failed to satisfy the deductibility test in that the expenditure had not been “incurred” in the year ended 31 August 1975 but in the year ended 31 August 1976. The CIR assessed the company on the additional salaries in the 1975 assessment, but allowed the amounts as a deduction in the 1976 assessment. The TRA upheld the assessments on the ground that, for an expenditure to be incurred during the income year, there must be a definite commitment by the taxpayer in the income year to meet the expenditure. No such commitment had been made by the company in the year ended 31 August 1975. The case shows the need for private companies to keep minutes of resolutions passed after the end of each accounting year voting extra salaries or fees to the directors in order to show a pattern of such amounts accrued in the accounts each year to provide the necessary evidence of a commitment by the company to meet the amounts.

In TRA Case J54 (1987) 9 NZTC 1,302, it was agreed orally at a directors meeting in the 1984 income year that all profits of a private company would be paid as directors’ fees but payment would be deferred for a reasonable period to allow consolidation of profitability. It was held that the resolution created an existing liability which had been incurred. Thus, deduction of the fees was allowed in the 1984 income year.

In TRA Case L99 (1989) 11 NZTC 1,566, a private company resolved in November 1979:

“that as from the financial year commencing 1 February 1979 directors fees be paid … the amount to be decided after consideration of financial results for the year ending 31 January 1980.”

In August or September of each succeeding year it approved the company accounts, by resolution, for the year ending the previous 31 January and resolved that the provision for directors’ fees as set out be approved. It was held that by this practice a liability to pay directors’ fees had been incurred in the year for which accounts were prepared. The CIR did not, in this case, challenge the quantum of fees on the grounds that the amount was not ascertained until after the end of a relevant income year. The TRA did not, therefore, determine whether the deduction would be limited to any amount (eg the amount paid in a previous income year).

240.195 Music and dancing teachers

Costs, including travel and accommodation (but not entertainment) to attend congresses or refresher courses, are deductible by self-employed dancing teachers. The cost of entering competitions, travelling, books, and other expenses by self-employed teachers are deductible, and prizes won are income. Tuition fees,
examination fees, travelling, books, and other expenses incurred in gaining qualifications are capital expenditure in the case of self-employed musicians and not deductible, but the cost of keeping abreast of modern developments and techniques in the profession are allowable. Self-employed teachers are allowed subscriptions to the Dancing Teachers’ Federation or any other association connected with their profession. Magazines, books, records, CDs and DVDs should be capitalised and depreciated unless allowed as a deduction under the low value asset write off provisions [see 250 DEPRECIATION].

No deduction is allowable for conventional clothing worn by a self-employed teacher at normal lessons, but special clothing, eg evening dresses necessary for teachers acting as partners of pupils appearing at competitions or examinations, and the cost of dry cleaning special clothing, may be deducted. Any extra expenditure incurred by self-employed teachers for hairdressing or make-up on occasions such as competitions may be deducted, but normal expenses under this heading are private and not deductible. Records and tapes required for teaching may be charged to revenue by self-employed teachers. The cost of travelling from home to studio is private, but the cost of travelling between studios is deductible.

240.200 Research and development [ss DB 26, DB 27, EJ 20, EJ 21]
A regime for the deductibility of expenditure on research and development is provided by s DB 26 with key definitions being provided in s DB 27. Use of the rules is optional. Taxpayers are able to use the general and specific deductibility rules contained elsewhere in the Act should they so choose [see 1240 RESEARCH AND DEVELOPMENT].

240.205 Financial planning fees
The CIR’s policy in relation to the deductibility of fees paid for financial planning services is set out in TIB vol 12:5 (May 2000) at 26-46. The main points of the interpretation statement are as follows:

(a) **Passive investors**: Initial planning fees and implementation fees will generally be non-deductible as they relate to the financial structure. Administration and monitoring fees will generally be deductible. Evaluation, replanning and switching fees will generally be deductible provided they result in no major significant change to the income-earning structure.

(b) **Speculative investors**: Investments held by speculative investors are revenue account property and the gross proceeds derived from the sale of the investments will be taxable. Generally, initial planning fees will be on capital account and not be deductible. Ongoing planning fees will generally be deductible provided that they have a nexus with a particular investment.

(c) **Business of investing**: Where the taxpayer is in the business of investing, all fees will generally be deductible. In certain circumstances the investment will be a financial arrangement and the financial arrangement rules will apply. In some cases, the pre-paid expenditure rules will have application. The circumstances under which these additional matters are relevant are discussed in the interpretation statement.

240.210 Resource consent and patent application costs [ss DB 19, DB 37]
The cost of a consent granted under the Resource Management Act 1991 to do something that otherwise would contravene ss 12 to 15 of the Resource Management Act 1991, is able to be depreciated as depreciable intangible property. A patent or the right to use a patent is afforded the same treatment [see 250.105].

Where a consent or patent is not granted or the application is withdrawn, the costs are deductible to the extent to which they would have been depreciable property had the application been granted. The deduction is allowed in the income year in which the grant was refused or the application withdrawn.

240.215 Arrangements involving money not at risk [ss GB 45, GB 46, GB 47, GB 48, DB 58]
A deferred deduction rule targets aggressive tax arrangements that offer investors tax deductions greater in amount than the sum of money that they have invested in the arrangement. The rules apply generally from the 2004-2005 income year. The rules do not apply to arrangements entered into by the taxpayer prior to the beginning of the 2004-2005 income year unless, at the time of entering into the arrangement, the taxpayer...
could reasonably have anticipated that 10 or more persons would acquire an interest in the arrangement and 70 per cent or more of the allowable deductions of the person from the arrangement arise from an interest of that person in fixed life intangible property and/or software.

For the rules to apply, the following criteria must be present in the arrangement at some time after the commencement of the arrangement:

(a) The arrangement has a promoter who sells or issues, or promotes the selling or issuing of, the arrangement.

(b) The arrangement results in losses for the participant and any affected associates in the first three years.

(c) The person or an “affected associate” must have money that is not at risk, being funds borrowed on a limited or non-recourse basis or on the basis that no material repayment is required for a period of 10 or more years.

(d) The money that is not at risk must constitute 50 per cent or more of the property assets of the arrangement.

(e) The total cost of property held is more than 142.85 per cent of the cost of the property that consists of:

   (i) Land;
   (ii) Buildings;
   (iii) Plant or machinery;
   (iv) A 10 per cent or greater interest in shares in listed companies;
   (v) Shares acquired with the intention that the person will be a shareholder-employee of the company in receipt of employee remuneration; or
   (vi) Shares in foreign companies where the proceeds from the sale of the shares would not be assessable income other than under the Foreign investment fund rules.

In other words, less than 70 per cent of the property held is of the kinds listed above, etc.

An “affected associate” is defined as a loss attributing qualifying company and a shareholder in that company or any persons associated under subpart YB [see 70 ASSOCIATED PERSONS AND RELATIVES].

For the purpose of determining the quantum of money that is not at risk, a “limited-recourse loan” means a financial arrangement that is not an excepted financial arrangement. The term excludes money that has been provided on an arms-length basis by a lender who is not an associated person of the borrower and who regularly lends money on an arms-length basis, and who is resident in New Zealand or carries on business through a fixed establishment in New Zealand. Intra-group and intra-family loans are also generally excluded.

For the purposes of ascertaining the amount of income and deductions and the value of property held, intra-group balances are eliminated.

Where a group of persons consists of a partnership, joint venture or loss attributing qualifying company, the gross income, allowable deductions, resulting losses and the cost of property attributable to each person are calculated proportionately.

Having determined whether or not the arrangement falls within the rules, it is then necessary to determine whether or not the participant in the arrangement also falls within the rules for the particular income year. A participant will fall within the rules for an income year if:

(a) The participant is not a loss attributing qualifying company and has a loss from the arrangement for the income year, including any such loss attributed to the person by virtue of being a shareholder in a loss attributing qualifying company; and

(b) The participant and the affected associates, none of which is a loss attributing qualifying company, when considered together have a loss from the arrangement for the income year, including any such
loss attributed to the person by virtue of being a shareholder in a loss attributing qualifying company; and

(c) On the balance date (or latest balance date), of the participant and affected associates for the income year, the arrangement involves a “limited recourse loan” for which the participant or an affected associate is a borrower.

If the rules apply to the person for that income year, the participant is treated as having derived an amount of gross income calculated as follows:

\[
\text{(participant’s excess deductions / total individual excess deductions)} \times \text{total ineligible amount}
\]

where:

“Participant’s excess deductions” is the amount of excess deductions of the participant for the income year;

“Total individual excess deductions” is the total amount by which the deductions from the arrangement exceed the assessable income from the arrangement in that income year. This is arrived at by aggregating the amounts for the participant and each affected associate of the participant who is not an LAQC and who has, for the income year, an excess of deductions over assessable income from the arrangement;

“Total ineligible amount” is the lesser of:

(a) The total individual excess deductions for the group and the income year; and

(b) The total undischarged obligation of the participant and affected associates under the limited-recourse amount as at balance date.

Where the application of the formula results in an amount of deemed gross income, that person is deemed to have an allowable deduction of an equal amount in the following income year. This deemed allowable deduction is taken into account when applying the formula in that following income year. This will result in a greater loss for the purposes of the calculations.

For the purposes of deciding whether or not the arrangement falls within the rules and also for the purpose of “total ineligible amount” in the formula, an obligation to repay a limited recourse amount is not discharged by a transaction to the extent to which the transaction:

(a) Involves the use, as part of the arrangement, of a put or call option that is not a contract for the sale for future delivery of goods at market value, or a contract of insurance or guarantee; and

(b) Does not give rise to gross income for the borrower of the limited recourse amount.

### 240.220 Guarantee fees paid

Guarantee fees paid in the normal course of business are deductible.

(a) A lump-sum payment for a guarantee of a loan or overdraft to be used by the taxpayer as capital in the derivation of assessable income is deductible [s DB 5].

(b) A commission paid for the guarantee of a floating debt was deductible: *Ascot Gas Water Heater Ltd v Duff* (1942) 24 TC 171 (KB).

(c) Fees payable annually during the life of a guarantee were not sufficient to exclude rights of deduction: *Ure v Federal Commissioner of Taxation* (1981) 11 ATR 484, 81 ATC 4100 (FCA).

(d) A company which was called upon to meet a guarantee obligation given for a group subsidiary was denied a deduction for payments made: *Knightsbridge Carpets Ltd v Inland Revenue Commissioner (New Zealand)* (1970) 2 ATR 78 (SC).

(e) An actual loss must be incurred in the relevant tax year and an expectation of a future loss is not sufficient: *Bendix Consolidated Industries v Federal Commissioner of Taxation* (1983) 13 ATR 553, 82 ATC 4,582 (VSC).

(f) Guarantees may be financial arrangements and are referred to as security payments [see 90 BAD DEBTS AND BAD DEBTS RESERVES].
240.225 Loss on guarantee

A loss on a guarantee made in the ordinary course of business is deductible. A loss on a guarantee made other than in the ordinary course of business is a loss of capital [s DA 2(1)], and not deductible although the fee received is assessable: TRA Case F62 (1983) 6 NZTC 59,870.

240.230 Feasibility expenditure

Feasibility expenditure is not a defined term. Accordingly, interpretation statement IS 08/02 Deductibility of Feasibility Expenditure, provides guidelines that are relevant to determining whether feasibility expenditure is deductible under the general deductibility provisions [s DA 1, see TIB vol 20:6 (July 2008) at 12-37].

Generally, feasibility expenditure is expenditure incurred by a taxpayer for determining the practicability of a new proposal. A typical feasibility exercise would involve determining whether a particular course of action should be taken or certain capital assets acquired or developed. Depending on the circumstances, feasibility expenditure may include the cost of carrying out surveys or studies (eg engineering surveys, environmental studies, and geological and geophysical studies), conducting comparative industry and market research, engaging professionals (eg lawyers, consultants and financial analysts), producing samples or prototypes, and travel costs. Feasibility expenses may be closely related to existing operations or may relate to proposals to expand the existing business or commence a new business.

Feasibility expenditure is deductible when it is incurred as an ordinary incident of the business or income-earning process. This requires that the expenditure must be undertaken as an ordinary incident of a particular business or income-earning activity (ie the activity must be carried out with the intention of obtaining assessable income). Feasibility expenditure incurred before or in preparation of the establishment of a business or income-earning activity will not be deductible. A determination of when the business or income-earning activity commences is critical to establishing whether or not the expenditure is deductible. The profit making structure must have been established and current operations must have begun in order for the business to have commenced.

For feasibility expenditure to be deductible there must be a sufficient relationship or nexus between the expenditure and the taxpayer’s business or income earning activity. The correct characterisation of the nature of the relevant business is vital to resolving whether there is a sufficient nexus between the expenditure and a taxpayer’s business. The activities must be characteristic of that kind of business and the expenditure must be incurred as part of the ordinary business operations.

In many situations, the expenditure will not be deductible on the basis that it is capital in nature [see 240.35].
Chapter 250

Depreciation

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### Depreciation regime [ss DA 1, DA 2, DA 4, EE 1]

As a general principle, the capital limitation [s DA 2(1)] prohibits a deduction for any expenditure or loss to the extent it is capital in nature. The cost of property (either tangible or intangible) acquired or constructed for use in a business is therefore not generally deductible, except for low value items [250.80]. However, taxpayers are entitled to a deduction for depreciation if the general permission is satisfied and none of the general limitations [s DA 2] apply. Under the general permission, a deduction for depreciation is available if it is incurred in deriving assessable or excluded income, or in carrying on a business for the purpose of deriving assessable or excluded income. To confirm this entitlement, s DA 4 effectively excludes depreciation losses from the application of the capital limitation.
The term “depreciation” refers to the process of writing off or expensing the cost of a fixed asset over its estimated useful life. A proportion of the total cost (or value) of the asset is expensed each year. Depreciation for income tax purposes is calculated in a similar way to depreciation for accounting purposes.

In the income tax legislation:

(a) Assets for which depreciation can be claimed are referred to as “depreciable property” [250.60];
(b) Depreciation is referred to as a “depreciation loss” [250.20];
(c) Depreciation recovered on the disposal of an item of depreciable property is referred to as “depreciation recovery income” [250.30];
(d) The written-down value (book value) of an item of depreciable property is referred to as its “adjusted tax value” [250.120].

The rules for calculating the amount of the depreciation loss or depreciation recovery income are set out in subpart EE.

**Depreciation denied on depreciable property used in deriving employment income [s DA 2(4)]**

The general permission is overridden by the employment limitation, which denies a deduction for any expenditure or loss (including a depreciation loss) incurred in deriving income from employment.

**Example:**

An employee claims actual expenses (instead of the approved Inland Revenue distance rates) from her employer for the use of her private motor car in the employer’s business. When completing her personal income tax return she cannot claim a depreciation loss as an allowable deduction to offset the allowances received from her employer for the use of the motor vehicle.

Payments to contract delivery drivers, engaged by restaurants to deliver food to customers, are not income from employment. Such contractors are able to claim depreciation on vehicles they own and use for delivering food [see Product ruling BR Prd 03/01, TIB vol 15:4 (April 2003) at 5–9].

**250.20 Depreciation loss [s EE 1]**

A depreciation loss arises in an income year when:

(a) A person owns an item of property;
(b) The item is depreciable property;
(c) The item is used, or available for use, by the person in the income year; and
(d) The amount of depreciation loss for the person, the item, and the income year, is calculated under ss EE 9, EE 10 and EE 11.

An amount of depreciation loss is treated as incurred in the income year for which it is calculated.

An item of depreciable property is deemed to depreciate at the appropriate diminishing value rate regardless of whether that amount was claimed as a deduction or not. Thus, when the item is disposed of, the disposal value is the adjusted tax value. Depreciation deductions are allocated to an income year under s BD 4. In certain circumstances taxpayers who hold depreciable property can elect under s EE 8 that the property not be depreciable property [see 250.70].

**No depreciation loss in the year of disposal [s EE 11]**

No depreciation loss arises in the income year in which an item of depreciable property is disposed of. However, for most types of depreciable property an adjustment is made to take account of the amount of depreciation over- or under-claimed over the total period of ownership. The main exceptions to this are for buildings and petroleum-related depreciable property.

**250.30 Depreciation recovery income [ss CG 1, EE 1]**

Depreciation recovery income arises in an income year if:

(a) A person owns an item of property [250.50];
(b) The item is depreciable property [250.60];
(c) The item is disposed of or an event of a kind described in s EE 44 [250.440] occurs; and
(d) The amount of depreciation recovery income is calculated for the person, the item, and the income year under any of the following provisions:

(i) Negative pool value [250.160]
(ii) Low value items [250.80];
(iii) Principal disposal rules [250.480];
(iv) Disposal of partial-income use items [250.500];
(v) Items lost or stolen [250.520]; or
(vi) Compensation received [250.530].

An amount of depreciation recovery income is treated as derived in the income year for which it is calculated. Section CG 1 provides that an amount of depreciation recovery income that a person has is income of the person.

The most common way in which depreciation recovery income arises is when an item of depreciable property is sold for more than its adjusted tax value (tax book value).

Example:
A self-employed business person sells their four-year-old business car, which has an adjusted tax value of $10,500, for $12,000. In the income year in which the car is sold, the person has depreciation recovery income of $1,500 ($12,000 − $10,500).

250.40 Arrangements to defeat depreciation rules [s GB 33]
An anti-avoidance provision prevents a taxpayer from claiming a deduction for depreciation if the taxpayer’s depreciable property has been subject to an arrangement aimed at defeating the depreciation rules. If an item of depreciable property of a person has been subject to an arrangement allowing the person or any other person to have a depreciation deduction and the purpose of the arrangement is to defeat the intent or application of the ITA, the relevant person is denied such a deduction.

250.50 Meaning of ownership [ss EE 2, EE 3, EE 4, EE 5]
“Own”, for the purposes of the depreciation rules, means legal or equitable ownership. Ownership is specifically defined in relation to goods that are subject to reservation of title and improvements made to leasehold land by a lessee.

When more than one person owns an item of depreciable property, each person is regarded as owning their respective interest in the depreciable property. For example, two equal partners in a partnership are each deemed to own a 50 per cent interest in depreciable property owned by the partnership and will claim 50 per cent of the depreciation losses.

Deemed ownership also arises for personal property assets (other than bloodstock and livestock) subject to a finance lease [s FA 6] or hire purchase agreement [s FA 12].

250.60 Depreciable property [ss EE 6, EE 7]
Depreciable property is any property (except for that listed below) that might reasonably be expected, in normal circumstances, to decline in value while used or available for use in deriving assessable income, or in carrying on a business for the purpose of deriving assessable income. Intangible property is depreciable property if it falls within the definition of “depreciable intangible property” [see 250.360] and is not excluded below.

The following types of property are specifically excluded from the definition of depreciable property:

(a) Land (excluding buildings, fixtures and improvements listed in sch 13);
(b) Trading stock;
(c) Livestock subject to subpart EB;
(d) Financial arrangements;
(e) Excepted financial arrangements;
Property that will not decline in value (as far as the owner is concerned), because of any right that the owner has to receive compensation for any decline in its value;

Property that the owner elects to treat as not depreciable [250.70];

Property that the owner has elected to treat as low-value property [250.80];

Property for whose cost a person, other than the property’s owner, is allowed a deduction;

Property for whose cost a person is allowed a deduction under a provision of the ITA 2007 outside of the depreciation rules [subpart EE] or under a provision of an earlier Act – not being mining assets used to derive income other than income from mining.

Example:
Under normal circumstances, an original painting would not be expected to decline in value and would therefore not meet the definition of depreciable property. Original paintings normally increase in value over time. An original painting on display in the offices of a business, for example, cannot be depreciated unless it can be shown that the painting is expected to decline in value. On the other hand, prints used as furnishings in hotels and restaurants can be depreciated [see TIB vol 10:9 (September 1998) at 12]. Similar principles would apply to the tax treatment of other appreciating assets employed in deriving assessable income.

Election that property not be depreciable [s EE 8]

A person may choose that an item of property not be treated as depreciable property in the following circumstances:

(a) When a person acquires an item of property that fits the definition of depreciable property, they can elect that it not be depreciable property.

(b) When the use of an item of property owned by a person changes, with the result that non-depreciable property becomes depreciable property, the person may choose that it not be depreciable property.

(c) A person that owns an item of depreciable property for which they have not claimed any depreciation loss despite being entitled to do so, may elect retrospectively that the item of property not be depreciable property.

Note: One of the main reasons why the option not to depreciate property was introduced in 1997 was to enable taxpayers to avoid the impact of the depreciation recovery and loss rules (250.480 to 250.500) on the sale of their home after the home had been rented out temporarily. With the loss of the ability to claim depreciation on buildings (that have an estimated useful life of 50 years or more) from the 2011–2012 income year, the need for s EE8 has largely been removed.

Once an election not to treat property as depreciable property has been made, it has effect in the income year of election and in all subsequent income years, until the item is disposed of or an event described in s EE 47 occurs involving the item [250.460]. A disposal of intangible property as part of an arrangement to replace it with property of the same type [s EE 44(2)(a)] is not treated as a disposal for these purposes.

The circumstances in which a taxpayer can make an election that property not be depreciable, and the appropriate mode of election, are as follows:

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<td>Giving the CIR notice in the return of income for the income year in which the property is acquired.</td>
</tr>
<tr>
<td>Property changing from non-business use to business use.</td>
<td>Giving the CIR notice in the return of income for the income year in which the change of use occurs.</td>
</tr>
<tr>
<td>Property in respect of which the taxpayer has omitted to claim a depreciation loss since the time of acquisition.</td>
<td>Giving the CIR notice in the return of income for any income year after the property was acquired including any income year after the property has been disposed of.</td>
</tr>
</tbody>
</table>
250.80 **Items of low value** [s EE 38]

When a taxpayer acquires an item of depreciable property for $500 or less during an income year, the taxpayer may elect to deduct the total cost of the property in the income year of purchase, instead of depreciating it. This option is available only if all of the following conditions are met:

(a) The person uses the item or has it available for use in the income year;
(b) The item would be depreciable property if not treated as an item of low value;
(c) The item has not and will not become part of any other item of depreciable property;
(d) The taxpayer is denied a deduction for the cost of the item if the item is not treated as an item of low value; and
(e) If the item is one of a group of items acquired at the same time and from the same supplier, and the same depreciation rate would apply if they were all treated as items of depreciable property, the total cost of all the items must not exceed $500.

The election to treat an item of depreciable property as an item of low value is made simply by claiming a deduction for the cost of the property in the tax return. The tax deduction is regarded as an amount of depreciation loss. Thus, if the item is subsequently disposed of, the full receipt constitutes depreciation recovery income under s EE 38(5).

When an item of low value for which a taxpayer has claimed a depreciation loss ceases to be used mainly for business purposes, or to derive assessable income, for the taxpayer and such use is not subject to FBT, it is deemed to have been disposed of for a consideration equal to its market value at the time at which the property ceases to be so used or available for use.

The threshold value for an item to be treated as an item of low value was $200 before 19 May 2005.

250.90 **Depreciation methods** [ss EE 9, EE 12]

Three depreciation methods can be used for income tax purposes:

(a) Diminishing value method;
(b) Straight-line method; and
(c) Pool method.

Taxpayers choose which depreciation method they will use for each item of depreciable property that they own. There is no general requirement to apply the same method to all items of property. The choice as to which method to use is made by adopting the appropriate depreciation method and rate in the annual return of income. Once the election is made, it cannot be changed for that item and that income year. However, if the depreciation method is changed for a subsequent income year, regard must be had to what the appropriate cost or adjusted tax value is for the straight-line and diminishing value methods.

An item of property may be included in a depreciation pool if it meets the definition of poolable property [see 250.140]. Once included in a pool, an item of poolable property cannot be depreciated under another method.

1) **Diminishing value (DV) method**

The diminishing value method is probably the most commonly used. This method allocates a higher proportion of depreciation loss to the initial years of ownership of an item than the straight-line method. Under the DV method a constant percentage of the “adjusted tax value” (essentially cost less accumulated depreciation loss deductions) of the depreciable property is used in determining the deductible depreciation loss. The depreciation loss for the year is then deducted from the property’s adjusted tax value to arrive at the immediately succeeding year’s adjusted tax value.

**Example:**
Office equipment costing $10,000 that has a DV rate of 33 per cent is depreciated as follows:
Depreciation

<table>
<thead>
<tr>
<th>Year</th>
<th>Adjusted tax value at year start</th>
<th>Depreciation (33%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1</td>
<td>$10,000</td>
<td>$3,300</td>
</tr>
<tr>
<td>20X2</td>
<td>$6,700</td>
<td>$2,211</td>
</tr>
<tr>
<td>20X3</td>
<td>$4,489</td>
<td>$1,481</td>
</tr>
</tbody>
</table>

The DV method cannot be used to depreciate fixed life intangible property [250.370].

(2) **Straight-line (SL) method**

The straight-line method allocates the cost of an item of depreciable property evenly over the item’s estimated life. Thus, for each income year, a constant percentage of the cost of the property is deducted from its adjusted tax value.

**Example:**

Office equipment costing $10,000 that has a SL rate of 24 per cent is depreciated as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Adjusted tax value at year start</th>
<th>Depreciation (24%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1</td>
<td>$10,000</td>
<td>$2,400</td>
</tr>
<tr>
<td>20X2</td>
<td>$7,600</td>
<td>$2,400</td>
</tr>
<tr>
<td>20X3</td>
<td>$5,200</td>
<td>$2,400</td>
</tr>
</tbody>
</table>

The straight-line depreciation method can be used for all items of depreciable property. However, it must be used to depreciate fixed life intangible property.

(3) **Pool method**

The pool method allows taxpayers to pool together similar items of depreciable property and depreciate them as a single item. Only items costing $2,000 or less can be pooled. The pool method cannot be used for buildings and fixed life intangible property.

The value of a pool is averaged over its opening and closing values taken at the start and end of each income year, with the depreciation loss determined similarly to the diminishing value basis, using a rate attributable to the items in the pool, or the lowest applicable rate for an item in the pool if there are items of different classes in a pool. Taxpayers may operate more than one pool. See 250.150.

**250.100 Calculating depreciation** [ss EE 10, EE 13, EE 14, EE 15, EE 16]

The amount of depreciation loss for an income year for an item of depreciable property using the diminishing value or straight line methods is calculated using the following formula:

\[
\text{annual rate} \times \text{value or cost} \times \text{months} \div 12
\]

Where:

“Annual rate” is the rate that applies to the item of depreciable property under the depreciation method and is expressed as a decimal [250.110].

“Value or cost” is defined separately for the DV and SL methods. If the DV method is used, value or cost is the item’s adjusted tax value at the end of the income year before the deduction of an amount of depreciation loss for that year. If the SL method is used, value or cost is the item’s cost to the person. The term cost explicitly excludes expenditure for which the person has been allowed a deduction outside of the depreciation rules in subpart EE.

If the depreciable property is a patent or a plant variety right acquired in the 2005–2006 or later income year, and the person has been allowed a depreciation deduction in a previous income year, the property’s “value or cost” is its adjusted tax value at the start of the month in which the person acquires the item.

“Months” is defined as follows:
Depreciation

250.110

(a) When a person’s income year contains 365 days (366 in a leap year) or less, the term “months” means the lesser of 12 and the number of whole or part calendar months (whole calendar months in the case of a patent application) in the income year in which the person owns the item and uses the item or has it available for use for any purpose.

(b) When a person’s income year contains more than 365 days (366 in a leap year), the term “months” means the number of whole or part months (whole months in the case of a patent application) in that income year in which the person owns the item and uses the item or has it available for use for any purpose.

It is not necessary for property to have been owned and available for use for the whole of a month in order for a depreciation loss to be claimed for that month. For example, for a 31 March balance date taxpayer, an item of depreciable property purchased and available for use on 28 January would qualify for a depreciation loss for the months of January, February and March.

Depreciation can be claimed in respect of an item of depreciable property only if the item is owned by the taxpayer and is actually used or available for use in deriving the taxpayer’s assessable income or in carrying on a business. For example, depreciation cannot be claimed for an item which is owned by a taxpayer but not yet in the taxpayer’s possession.

An item of depreciable property is treated as being available for use while it is temporarily subject to repair or inspection if it was used or available for use immediately before going for repair or inspection [s EE 10].

The amount of depreciation loss calculated for an item for an income year under the DV or SL method must not exceed the item’s adjusted tax value [s EE 14(1)]. This rule ensures that the total amount of depreciation loss claimed over the life of the item does not exceed the item’s cost. In determining the depreciation loss for the income year, it will not often be necessary to make a direct comparison with the adjusted tax value as this will be obvious. However, when it is necessary to make a comparison, the comparison is made with the adjusted tax value of the item for the income year before any deduction for depreciation loss for the item for that year [s EE 15].

250.110 Annual rate [s EE 61]

The “annual rate” is the annual depreciation rate that applies to an item of depreciable property. The annual rate that applies to a particular item of depreciable property depends on the date of acquisition and the type of property:

<table>
<thead>
<tr>
<th>Type of depreciable property</th>
<th>Applicable rate</th>
<th>Staples paragraph</th>
</tr>
</thead>
<tbody>
<tr>
<td>International aircraft acquired in the 1995–1996 or a later income year</td>
<td>15% DV or 10% SL</td>
<td>250.260</td>
</tr>
<tr>
<td></td>
<td>The rate is set by s EE 31(2)(c) or s EE 31(3)(b)</td>
<td></td>
</tr>
<tr>
<td>Fixed life intangible property that is not excluded depreciable property</td>
<td>The rate set by s EE 33</td>
<td>250.370</td>
</tr>
<tr>
<td>Patents acquired in the 2005–2006 or a later income year</td>
<td>The rate set by s EE 34</td>
<td>250.390</td>
</tr>
<tr>
<td>Depreciable property, that is not excluded depreciable property or fixed life intangible property, acquired before the end of the 1994–1995 income year</td>
<td>The rate set by s EZ 13</td>
<td>250.640</td>
</tr>
<tr>
<td>Excluded depreciable property (as defined in s EE 64)</td>
<td>The rate set by s EZ 15</td>
<td>250.660</td>
</tr>
<tr>
<td>For certain operating leases, for income years commencing after 20 June 2007</td>
<td>Five-sixths of the depreciation otherwise allowable [s FA 11B(7)]</td>
<td>900.35</td>
</tr>
</tbody>
</table>
Type of depreciable property | Applicable rate | Staples paragraph
--- | --- | ---
Buildings with an estimated useful life of 50 years or more acquired in the 1995–1996 or a later income year (with effect from the 2011–2012 income year) | The rate set by s EE 31(2)(d) or s EE 31 (3)(c) | 250.240
Special excluded depreciable property that would be excluded depreciable property but for the exclusion in s EE 64(3) | Zero per cent for all depreciation methods (with effect from the 2011–2012 income year) [s EE 61(7B)] | 250.670
Depreciable property acquired in the 1995–1996 or a later income year, to which none of the above provisions applies | The rate set by s EE 31(2)(a) or (b) or s EE 31(3)(a) | 250.270

For a comprehensive schedule of economic depreciation rates that apply for depreciable property acquired after 1 April 2005 see 5000 DEPRECIATION RATES.

250.120 **Adjusted tax value** [ss EE 54, EE 55, EE 56, EE 57, EE 58, EE 59, EE 60]

Adjusted tax value (ATV) is the undepreciated balance of the cost or value of an item of depreciable property at any point in time. In accounting terminology, it is the book value. For a pool, adjusted tax value is the amount of the adjusted tax value determined under s EE 21 [see 250.150]. For items of depreciable property that are depreciated separately, adjusted tax value is determined by applying the following formula:

\[
\text{base value} - \text{total deductions}
\]

**(1) Base value** [s EE 57]

The general rule is that the base value is the cost of the item of depreciable property to the person.

If the person is registered for GST, cost is the net amount after deducting input tax [s EE 54]. In addition, cost is:

(a) Reduced by the amount of any adjustment taken into account in the income year under s 20(3)(e) of the GST Act [see 580.127].

(b) Increased by adding the amount of deductible output tax the person has for the income year [see 580.180].

The term “cost” is modified to exclude expenditure that has been allowed as a deduction under any other subpart of the ITA 2007, or if the property qualified for the items of low value deduction [250.80]. Any depreciation loss on disposal of an item is also excluded from its cost. Depreciation loss claimed in respect of an item does not reduce the item’s cost. The term cost also includes the corresponding deductions under the earlier rules, which are now included in the terminating provisions in s EZ 22.

In the case of an item (other than a building or petroleum-related depreciable property) that was previously not depreciable (eg because it was purchased for private purposes), but that has subsequently become depreciable, base value is the market value at the time the owner starts to use it, or to have it available for use, for the purpose of deriving assessable income or carrying on a business for the purpose of deriving assessable income [s EE 58].

**Example 1:**
Pamela bought a car for her private use for $10,000. She subsequently left her job as an accountant and set up in business on her own account. She will use her car in the business. The base value of the car is its market value at the time Pamela first used the car in the business, $8,000.

This rule does not apply if the item is purchased for business purposes but is not immediately available for use. This ensures that the whole cost of an item can be depreciated if it was purchased for business purposes but is not immediately available for use [s EE 58(1)(c)]. In this case, the general rule [s EE 57] would apply.
**Example 2:**
George purchased a machine for his business from a supplier in London for $50,000. He took legal ownership of the machine at the time it was loaded onto a ship in Southampton. Owing to major mechanical problems, the ship did not reach New Zealand until 11 months later, at which time George took delivery of his machine. By the time George actually took possession of the machine, its market value had dropped to $40,000. However, the base value of the machine is its cost of $50,000. Thus, even though George cannot claim depreciation losses until he receives delivery of the machine, he will still be able to claim depreciation on the total cost.

(2) **Total deductions** (s EE 60)

“Total deductions” is the total of all depreciation deductions that have (or could have) been deducted for an item since it was acquired. It is the sum of the following three amounts:

(a) The total of all amounts that have been required to be deducted from an item’s adjusted tax value, since the start of the 1993–1994 income year, where insurance or other compensation received exceeds the expenditure incurred by the owner because of the event for which the compensation was received, under s EE 52(2) or the equivalent provisions in the ITA 2004, ITA 1994, and ITA 1976;

(b) The total of all depreciation deductions:

(i) That were allowed for the item. If the item is a patent, this includes depreciation deductions for the patent application. If the item is a geothermal well acquired in the 2005–2006 or later income year, this includes depreciation deductions for the well before it was acquired; or

(ii) That would have been allowed (using the DV method) for the item, if it had been used wholly in deriving assessable income or carrying on a business for the purpose of deriving assessable income. From the 2008–2009 income year, this does not include items that have been withdrawn from use in deriving assessable income or carrying on a business, except for an amount of depreciation loss deducted under s EE 39 [see 250.430];

(c) The amount of a “catch-up” deduction for plant variety rights under s EE 25 [see 250.400].

The total of the depreciation deductions in (b) is calculated for the period starting with the applicable one of the following starting dates and ending at the end of the preceding income year. The starting dates are as follows:

<table>
<thead>
<tr>
<th>Condition</th>
<th>Starting date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Default condition (if none of the following three conditions apply)</td>
<td>The date on which the item was acquired.</td>
</tr>
<tr>
<td>In the case of a geothermal well that is deemed to be acquired under s EE 53(2), the starting date is the earliest date on which the person acquired the well under s EE 47(6).</td>
<td></td>
</tr>
<tr>
<td>In the case of a patent for which a person acquired a patent application, the starting date is the date the person acquired the patent application.</td>
<td></td>
</tr>
<tr>
<td>The item is one to which s EE 58 applies (ie, not previously depreciable). Section EE 58 applies to items that have been converted from a non-business to a business use [see “Base value” above].</td>
<td>The beginning of the month in which the person started using the item, or having it available for use, for the purpose of deriving assessable income or carrying on a business.</td>
</tr>
<tr>
<td>In the case of a patent for which a person acquired a patent application, the starting date is the beginning of the month in which the patent application was acquired.</td>
<td></td>
</tr>
<tr>
<td>Petroleum-related depreciable property is acquired by person A from an associated person under s EE 59.</td>
<td>The date on which the property is acquired by person A or the relevant associated person.</td>
</tr>
</tbody>
</table>
Condition | Starting date
--- | ---

The definition of “total deductions” means that if an item is used for a period for a non-business purpose, the item is deemed to have been depreciated on a DV basis during that period even though no deduction is available. If the owner of that item subsequently uses it for a business purpose, the amount available for depreciation is reduced by that deemed depreciation. However, if the item was purchased for business purposes and has only ever been available for business purposes, but was simply unavailable for use for a period, the item is not deemed to have been depreciated during that period. This ensures that a taxpayer is not penalised when an item, which is only ever available for business use, is unavailable for use for a period (eg the period between purchase and delivery).

**Example:**
Michael Ltd, a standard balance date company, purchases a new bulldozer on 16 September for $200,000. Michael Ltd elects to use the DV depreciation rate of 13 per cent. The bulldozer is owned for seven months of the income year from September through to the following March. The depreciation calculation is:

\[ 13\% \times 200,000 \times \frac{7}{12} = 15,167 \]

The depreciation loss is therefore $15,167. The adjusted tax value at the start of the following income year is:

\[ 200,000 - 15,167 = 184,833 \]

### 250.130 Changing depreciation methods [ss EE 12, EE 18, EE 55, EE 56, EE 57, EE 58, EE 59, EE 60]

A taxpayer who has elected to use the SL or DV method for an item of depreciable property in any particular income year may not change methods after filing that year’s tax return, but can make a different election in a subsequent year. A taxpayer elects which depreciation method to use simply by using it in that year’s tax return. However, if a taxpayer elects to pool an item, that item must continue to be pooled for as long as the taxpayer owns it. An election to pool is effectively permanent.

If a taxpayer changes from the DV method to the SL method for an item, it must be depreciated by writing-off in equal annual instalments the adjusted tax value (as though that value were the item’s cost) at the time of switching to the SL method [s EE 18]. Taxpayers in this situation must use the ATV instead of cost as the base for the SL method so they do not gain an unfair advantage by switching methods partway through an item’s life.

**Example:**
Philippa bought a jet boat at the beginning of income year one for $20,000. At the end of income year three it had been depreciated at 20 per cent DV down to $10,240, and Philippa decided to switch to the SL method. The equivalent SL rate equivalent to 20 per cent DV is 13.5 per cent. Applying the SL method 13.5 per cent of $10,240 (or $1,382.40) will be deducted in each subsequent year Philippa continues to use the SL method, until the ATV is reduced to nil.

If a taxpayer switches an item of depreciable property from the SL method to the DV method, depreciation is calculated on the item’s ATV at the time of the change in method.

### 250.140 Pool method [ss EE 20-EE 24, EE 65, EE 66, EZ 9, EZ 10; TAA, s 91AAL]

The pool method of depreciation is aimed at reducing compliance costs by allowing taxpayers to depreciate items of low value collectively rather than individually. Only poolable property can be depreciated under the pool method.

“Poolable property” is defined in s EE 66 as an item of depreciable property (other than a building) that meets the following criteria:

(a) If the item is acquired during the income year, its cost does not exceed the maximum pooling value; and

(b) If the item was previously depreciated separately, its adjusted tax value at the start of the income year does not exceed the maximum pooling value; and
Depreciation

(c) The item is wholly used or available for use in deriving assessable income or carrying on a business for the purpose of deriving assessable income, or (if not used wholly for these purposes) it is used in a way that is subject to FBT.

The “maximum pooling value” is usually $2,000, but taxpayers may apply for a higher maximum pooling value for specific items under s 91AAL of the TAA. When deciding whether to allow a greater maximum, the CIR will consider whether the item is similar to other items in the pool, whether the taxpayer’s compliance costs will be reduced as a result of allowing the item in the pool, and how often the items are bought and sold.

250.150 Calculating depreciation loss for a pool [ss EE 21, EE 22]

The formula for calculating the depreciation loss for a pool of depreciable property is:

\[
\text{rate} \times \left( \frac{\text{starting adjusted tax value} + \text{ending adjusted tax value}}{2} \right) \times \frac{\text{months}}{12}
\]

Where:

“Rate” is the DV rate of depreciation applicable to all items included in the pool in the income year. If items with different rates are included in the pool, the rate is the lowest of those DV rates.

“Starting adjusted tax value” is the total of:

(a) The pool’s adjusted tax value at the start of the income year; and
(b) The adjusted tax value, as at the end of the previous income year, of any item that was previously depreciated separately and added to the pool during the year.

If the pool did not exist at the start of the income year, the starting adjusted tax value is zero.

“Ending adjusted tax value” is the result of the following calculation:

(a) The pool’s adjusted tax value at the end of the income year, before the deduction of the depreciation loss for the income year;
(b) Plus the cost of any items acquired during the income year and added to the pool during the year;
(c) Plus the adjusted tax value, on the date it is included in the pool, of any item that was previously depreciated separately and added to the pool during the year;
(d) Less the consideration derived from the disposal of any item in the pool.

“Months” is the number of whole or part months in the person’s income year. This number may be more or less than 12 when, for example, the person is commencing or ceasing business, or when the person has changed their balance date.

The formula for calculating the depreciation loss for a pool is built around the concept of calculating depreciation for the average value of the pool. When items with different annual rates were included in the pool at any time during the period, the lowest of those DV rates apply.

Example 1:

All of a shop’s depreciable property is included in a pool. These comprise:

- Cash register 40% DV
- Electric sign 20% DV
- Fittings 20% DV
- Furniture 20% DV

The rate for this pool is 20 per cent. It would be more tax effective to depreciate the cash register separately and combine the remaining assets in a pool.

Another situation in which it is more tax effective to maintain two separate pools is when the depreciation rate changes, so that items owned before the rate change might be in one pool and the items purchased after the rate change might be in the other pool.

The starting adjusted tax value is the pool’s adjusted tax value at the start of the income year. If the pool did not exist at that time, the value is zero. However, when an item of previously separately depreciable property

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Depreciation is included in the pool during the income year, the starting adjusted tax value is increased by the adjusted tax value of that item of property.

**Example 2:**
Offices Ltd has over 500 desks on which it claimed depreciation in previous years. At the beginning of the year each desk had an adjusted tax value of less than $2,000, and the combined value of all desks was $14,550. During the year it purchased 40 new desks for $600 each. When preparing the income tax return for the year it elects to form a pool for these desks. The pool depreciation is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pool value (ATV) at beginning</td>
<td>$14,550</td>
</tr>
<tr>
<td>Add purchases (40 x $600)</td>
<td>$24,000</td>
</tr>
<tr>
<td>Pool value (ATV) at end</td>
<td>$38,550</td>
</tr>
<tr>
<td>Average pool value ($14,550 + $38,550)/2</td>
<td>$26,550</td>
</tr>
</tbody>
</table>

If the applicable depreciation rate is 13 per cent, depreciation on the pool for the year is $3,451.

Once an asset is included in a pool it cannot generally be isolated from the pool at a later stage. An exception applies when an asset must be isolated because it is no longer poolable property under s EE 66, for example, when the item is used privately. In these circumstances s EE 24 deems the asset to have been disposed of and reacquired for its market value at the relevant time.

**Example 3:**
A pool with an adjusted tax value at 1 April of $18,000 includes an item which, on 5 December, begins to be used for private purposes for 20 per cent of the time and is thus no longer poolable property. The item has a market value of $1,500 on 5 December.

**Pool depreciation:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pool value at beginning</td>
<td>$18,000</td>
</tr>
<tr>
<td>Value at end ($18,000 less deemed sale $1,500)</td>
<td>$16,500</td>
</tr>
<tr>
<td>Pool value at end</td>
<td>$34,500</td>
</tr>
<tr>
<td>Average pool value (divide by two)</td>
<td>$17,250</td>
</tr>
</tbody>
</table>

If the applicable depreciation rate is 25 per cent, then depreciation on the pool for the year is $4,312.

**Depreciation of ex-pool asset:**

\[
25\% \times \$1,500 \times 4/12 \text{ (months)} \times 80\% \text{ (business use)} = \$100
\]

### 250.160 Acquisition and disposal of pooled items [s EE 22]

When a taxpayer elects to include in a pool an item of poolable property acquired by the taxpayer, the adjusted tax value of the pool must be increased by the cost of the item. When that item of poolable property has in the preceding income year been depreciated separately:

(a) The adjusted tax value of the pool is increased by the adjusted tax value of the item at the date of its inclusion in the pool; and

(b) The adjusted tax value of the property at the end of the preceding income year is included in the item “starting adjusted tax value” in the formula in 250.150.

Thus, the item will no longer have a separate adjusted tax value and any depreciation loss is now accounted for through the pool.

When an item is disposed of, the adjusted tax value of the pool is reduced by the consideration received [s EE 22(3)]. In effect, there is no cap on the depreciation recovery on disposal of an item of poolable property in these circumstances.

**Example 1:**
Shaky Ltd is a scaffolding contractor. At any time, it owns roughly $100,000 worth of scaffolding and buys new items regularly to replace items which are lost or worn out. At the end of the income year, the total adjusted tax value of all scaffolding is $87,000. The opening value of the pool for the next income year is therefore $87,000. During the next income year, the following events take place:

- May: $10,000 spent on new scaffolding.
Depreciation

250.170

• August: $4,000 received from insurance company for scaffolding stolen off site.
• January: $8,000 spent on new scaffolding.

The closing value of the pool is therefore:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening value</td>
<td>$87,000</td>
</tr>
<tr>
<td>Add purchases</td>
<td>$18,000</td>
</tr>
<tr>
<td>Deduct disposals</td>
<td>$4,000</td>
</tr>
<tr>
<td>Closing balance</td>
<td>$101,000</td>
</tr>
</tbody>
</table>

The applicable depreciation rate is 13 per cent. Applying the formula, the depreciation deduction for the scaffolding pool is:

$$13\% \times \frac{($87,000 + $101,000)/2}{12/12} = $12,220$$

If no consideration is received on the disposal of a pool item (eg, if the item is scrapped or lost), no reduction to the pool’s adjusted tax value is made. If the consideration received is greater than the value of the pool, the adjusted tax value of the pool is reduced to zero and the amount by which the adjusted tax value is negative is an amount of depreciation recovery income [s EE 22(5)(a)]. Even if the pool still has items in it, no further depreciation loss can be claimed in respect of the pool unless the pool has further items added and its adjusted tax value returns to a positive value.

Example 2:

Twenty items of depreciable property are in a pool.

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted tax value of the pool on 30 September</td>
<td>$34,000</td>
</tr>
<tr>
<td>Fifteen items sold on 31 October for consideration of</td>
<td>$36,000</td>
</tr>
<tr>
<td>Depreciation recovery income in the income year ended 31 March</td>
<td>$2,000</td>
</tr>
</tbody>
</table>

The adjusted tax value of the pool on 31 March, even though five items are still in the pool, is zero.

More than one pool may be set up for the same type of items. This may be useful where different rates apply because of different acquisition dates, or the items are used in different locations and separate records are desired.

The pooling regime does not allow the amount of any income derived on disposal to be restricted to the amount of depreciation actually deducted, as is the case with items depreciated separately. Taxpayers should therefore be wary of including in a pool any item which is likely to ultimately be sold for more than its original cost.

When all the items in a pool have been disposed of but the pool still has a positive value the remaining value of the pool is then deductible.

Example 6:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted tax value</td>
<td>$34,000</td>
</tr>
<tr>
<td>All items sold for</td>
<td>$26,000</td>
</tr>
<tr>
<td>Depreciation loss</td>
<td>$8,000</td>
</tr>
</tbody>
</table>

250.170 Adjusting for non-business use of motor vehicles [subpart DE, s EE 50]

Where an item of depreciable property is used for both business and non-business purposes, the depreciation must be apportioned. There are separate rules for motor vehicles and other property.

(1) Motor vehicles

Motor vehicles used in the business of a sole trader or partnership are subject to the deductibility rules in subpart DE. Subpart DE applies to motor vehicles that are used partly for business purposes and partly for other purposes [see 990 MOTOR VEHICLES]. Subpart DE does not apply to:

(a) A company motor vehicle;
(b) A person whose only income is income from employment;
Depreciation

(c) A motor vehicle that is used only in the course of deriving income; or
(d) A motor vehicle whose use constitutes a fringe benefit.

Private use of a motor vehicle that is owned by a company will either be subject to FBT (if the private use is by an employee or shareholder-employee) or will constitute a dividend (if the private use is by a shareholder). In either case, no apportionment of the depreciation is required.

When a motor vehicle is subject to the apportionment rules, the depreciation loss is limited to the amount calculated by the following formula in s DE 2(5):

\[
\text{standard calculation} \times \text{business proportion}
\]

Where:

“Standard calculation” is the amount as determined by the formula in s EE 16:

\[
\text{annual rate} \times \text{value or cost} \times \frac{\text{months}}{12}
\]

“Business portion” is the proportion of business use of the motor vehicle calculated under ss DE 3-DE 12.

Example:
Anne-Maree is a self-employed salesperson and has calculated using the logbook rules that her car is used 85 per cent for business purposes. The adjusted tax value (ATV) of the car is $18,000, and it is owned for the entire income year. The car was bought secondhand in the previous year, and the applicable depreciation rate is 30 per cent DV. First, applying the formula:

\[
30\% \times \$18,000 \times \frac{12}{12} = \$5,400
\]

Secondly, applying the apportionment formula in s DE 2(5):

\[
\text{standard calculation} \times \text{business proportion}
\]

\[
\$5,400 \times 0.85 = \$4,590
\]

The depreciation loss is $4,590. The adjusted tax value of the car reduces by the full amount of ATV ($5,400) to $12,600 [see definition of “total deductions” and s EE 60(3)(b)].

250.180 Adjusting for non-business use of other depreciable property

[s EE 50]

An apportionment calculation applies to the depreciation loss of other mixed-use property [s EE 50].

As with motor vehicles it is not applied when the private use is subject to the payment of FBT, which in itself is an apportionment mechanism. If all non-business use of property is subject to FBT then no further apportionment is required for depreciation purposes.

In terms of s EE 50(2) the depreciation loss available when an item of property has only partly business use must not be more than an amount calculated under the following formula:

\[
\text{depreciation loss} \times \frac{\text{qualifying use days}}{\text{all days}}
\]

Where:

“Depreciation loss” has the same meaning as is used generally for depreciation purposes.

“Qualifying use days” is the number of days in the income year that the person owns and uses (or has available for use) the property for the purposes of deriving assessable income, carrying on a business, or for a use that constitutes a taxable fringe benefit.

“All days” means the number of days in the income year that the person owns the property and uses or has it available for use.
Depreciation

If a unit of measurement other than days, such as time or distance travelled, etc, would give a more appropriate result when used in the formula in s EE 50, then that unit of measurement must be used.

Example 1:
Max is a self-employed car dealer who owns a caravan. In the current income year he used the caravan as a temporary sales office for eight months while a new office was being built, and took it on holiday for one month. For the rest of the year it was not used, but available for use. At the start of the income year the caravan had an adjusted tax value of $3,500, and a depreciation rate of 16 per cent DV applied. First, when applying the formula in s EE 50(2):

\[
\text{annual rate} \times \text{value or cost} \times \text{months}
\]

\[
\frac{16\% \times $3,500 \times 12}{12} = $560
\]

Secondly, applying the formula:

\[
\text{depreciation loss} \times \text{qualifying use} \div \text{months}
\]

\[
\frac{$560 \times 11}{12} = $513
\]

In this case months was used instead of days [s EE 50(4)]. Eleven months is the period that the caravan was used and available for business use, with the private portion being the one month holiday. The depreciation loss is $513. The adjusted tax value is reduced by the full depreciation loss of $560.

Example 2:
A house is used for private living and has an area of 20 per cent used for business. The cost price of the house (excluding land) is $150,000 and the depreciation rate is two per cent SL. The unit of apportionment is area (ie square meters).

<table>
<thead>
<tr>
<th>Year</th>
<th>ATV</th>
<th>Annual depreciation</th>
<th>Private use adjustment</th>
<th>Depreciable loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1</td>
<td>$150,000</td>
<td>$3,000</td>
<td>$2,400</td>
<td>$600</td>
</tr>
<tr>
<td>20X2</td>
<td>$147,000</td>
<td>$3,000</td>
<td>$2,400</td>
<td>$600</td>
</tr>
<tr>
<td>20X3</td>
<td>$144,000</td>
<td>$3,000</td>
<td>$2,400</td>
<td>$600</td>
</tr>
</tbody>
</table>

250.190 Improvements [s EE 37]

(1) Income year in which improvement made

When an improvement is made to an item of depreciable property, the improvement is treated as a separate item of depreciable property in the year the improvement is made. The improvement is depreciated from the start of the month in which the improvement is first used or available for use to the end of the income year.

Example:
A manufacturing company owns an item of plant that cost $50,000 and has an ATV, as at 31 March 20X1, of $21,949. The applicable economic rate for the plant is 20 per cent DV. In September 20X1, an additional component was added to the plant to improve its effectiveness, at a cost of $26,400. The improvement was available for use from 23 September 20X1. In the first income year (the year ended 31 March 20X2), assuming the same economic rate applies, depreciation on the improvement is calculated as:

\[
20\% \times $26,400 \times 7/12 = $3,080
\]

The ATV of the improvement as at 31 March 20X2 is $23,320 ($26,400 − $3,080).

For the year ended 31 March 20X2, depreciation on the original plant is $4,390 ($21,949 × 20%) and its ATV as at 31 March 20X2 is $17,559 ($21,949 − $4,390).

(2) Subsequent income years

In subsequent income years, the way in which the improvement is depreciated depends on the type of property and the date the improvement was acquired or made. The default position is that the taxpayer can either continue to treat the improvement as a separate item of depreciable property or treat it as part of the item of depreciable property that was improved. It can be beneficial to depreciate the improvement separately if the

Staples Tax Guide 2012
annual rate applying to the improvement is higher than the rate applying to the item improved. If the improvement is treated as part of the item of depreciable property that was improved, the following approach must be followed:

<table>
<thead>
<tr>
<th>Depreciation method used</th>
<th>How improvement is treated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diminishing value</td>
<td>ATV of improvement at start of income year is added to ATV of main item at start of income year.</td>
</tr>
<tr>
<td>Straight-line</td>
<td>ATV of improvement at start of income year is added to ATV of main item at start of income year, and the cost of improvement added to cost of main item.</td>
</tr>
</tbody>
</table>

**Example:**

Continuing the previous example, the ATV of the improvement as at the start of the second income year (1 April 20X2) is added to the ATV of the main item of plant at that date, giving $40,879 ($23,320 + $17,559). From 1 April 20X2, depreciation is calculated on this combined total ATV.

The following are exceptions to the default position explained above.

If the pool method of depreciation is used for the item of depreciable property that was improved [see 250.140], the improvement must be treated as a separate item of depreciable property. In the second and subsequent income years, the item must be included in the pool if its cost is less than or equal to the maximum pooling value (normally $2,000). When the improvement is included in the pool, the pool’s ATV is increased by the improvement’s ATV at the date it is included in the pool, and the improvement’s ATV at the end of the previous income year is included in the starting adjusted tax value.

An improvement must be treated as a separate item of depreciable property if:

(a) The improvement was acquired, or the decision to purchase or construct the improvement was made, after 20 May 2010 [see 250.270 for full details]; and

(b) The item that was improved is:

(i) A “grandparented structure”;
(ii) Not a building;
(iii) Not a used import car;
(iv) Not an international aircraft; and
(v) An item that has not been used or held for use in New Zealand as an item of depreciable property before the date it was acquired.

A “grandparented structure” [s YA 1] is any item in the following list if the item was acquired or a binding contract for the purchase or construction of the item was entered into, on or before 30 July 2009:

- Barns, including barns (drying);
- Carparks (buildings);
- Chemical works;
- Fertiliser works;
- Powder drying buildings;
- Site huts.

**Improvements made by lessee of land [ss EE 4 and EE 5]**

For the purpose of determining who is entitled to claim a deduction for depreciation on fixtures or improvements to leased land, the lessee is deemed to own a fixture or improvement to land (and therefore is entitled to claim depreciation) for the period of the lease if:

(a) The lessee incurs expenditure in erecting the fixture or making the improvement during the period; and

(b) The fixture or improvement is (under land law principles) the property of the lessor.
The lessor, including any subsequent lessor who purchases the land from the original lessor, is deemed not to own the fixture or improvement (and therefore is not able to claim depreciation) either during the period of the lease or after the period of the lease, unless the lessor pays the lessee for the fixture or improvement at the end of the lease period. If a lessee’s interest in a lease is transferred, the transferee is deemed to own the fixture or improvement provided that the transferee pays the lessee for the fixture or improvement and the lessee has depreciated it [s EE 5(1)]. This applies on all subsequent occasions when the item is transferred by the lessee [s EE 5(2)].

250.200 Depreciable property under construction
Depreciation may be claimed on a partly constructed item provided the following conditions are met:
(a) The item constitutes “depreciable property” as defined in s EE 6 [see 250.60]; and
(b) The item is owned by the taxpayer.

In order to constitute depreciable property, the partly constructed property must reasonably be expected in normal circumstances to decline in value while being used, or available for use, in deriving assessable income or carrying on a business for the purpose of deriving assessable income.

No depreciation can be claimed on an item under construction until such time as the item, or some part of it, is in a state in which it either is used, or can be used, in deriving assessable income or in carrying on a business.

Note: Actual use is not necessary; a depreciation deduction is available if the item is merely available for use in deriving assessable income or in carrying on a business. The item cannot be depreciated unless it is reasonably expected to decline in value once in use or available for use.

Example:
A company intends to build a piece of machinery to use in its manufacturing business. It purchased all the component material in December, but did not complete the machine until June of the following year. At no time before its completion was the machine able to be used in deriving assessable income or in carrying on a business for the purpose of deriving assessable income. No depreciable property exists until June when the machine is completed because, before completion, it cannot be used in deriving assessable income or in carrying on a business for the purpose of deriving assessable income. Thus, since no depreciable property exists until June, depreciation deductions will not be allowed before this time.

See interpretation statement IS3175 for further details [see TIB vol 12:9 (September 2000) at 21–27].

250.210 Capital contributions [ss CG 8, DB 64]
When a person derives a capital contribution (as defined below) after 20 May 2010, the person has a choice as to how to treat the amount:
(a) The contribution can be treated as income, spread over 10 years (s CG 8); or
(b) The depreciation base of the item for which the contribution was received can be reduced by the amount of the capital contribution (s DB 64), thus reducing depreciation deductions.

A “capital contribution”, for the purposes of ss CG 8, DB 64 and EE 48, is an amount that is paid by the payer as a contribution for depreciable property owned or to be acquired by the recipient. The following conditions must be satisfied:
(a) The amount is paid by the payer to the recipient under an agreement between them that is not a contract of insurance;
(b) The amount is not paid by the payer in their capacity as settlor, partner or shareholder of the recipient;
(c) The amount is not income of the recipient, except under s CG 8; and
(d) The amount is paid under the express terms and conditions of the agreement.

(1) Capital contribution treated as income
If the recipient of a capital contribution decides to treat it as income under s CG 8, the capital contribution is spread evenly over the income year in which the contribution is derived and the following nine income years. One tenth of the capital contribution is treated as income for each of the 10 years. No adjustment is made if the contribution is received part way through an income year.
250.210(2) Depreciation

(2) Capital contribution deducted from depreciation base

If the recipient of a capital contribution elects to treat it as a reduction of the depreciation base of an item of depreciable property under s DB 64, the item’s ATV, base value, cost or value, as applicable, is reduced by the amount of the capital contribution.

An adjustment is required when an item, for which a capital contribution has been received, is disposed of for more than its ATV. See 250.480.

Example:
On 1 August 2012 a farmer asked his local electricity supplier to connect his new house to the electricity network. Because of the house’s remote location it will cost the electricity supplier $10,000 to do this work, so it requires the farmer to contribute $6,000 towards this cost. If the electricity supplier decides to treat the capital contribution as income, it must include $600 ($6,000/10) in each of its 2013 through 2022 income years. If the electricity supplier decides to reduce its depreciation base instead, it can only claim depreciation losses based on $4,000 ($10,000 − $6,000).

(3) Position before 21 May 2010

Prior to 21 May 2010, capital contributions were non-taxable capital receipts in the hands of the recipient, and the cost of the depreciable property was not reduced by the amount of the contribution.

250.220 Setting of economic depreciation rates [s EE 26]

The “economic rate” is defined as the economic depreciation rate of an item of depreciable property set under ss EE 27-EE 30 [s EE 67].

Different methods apply for setting the economic depreciation rates for the following categories of depreciable property:

<table>
<thead>
<tr>
<th>Kind of depreciable property</th>
<th>Section</th>
<th>Staples para</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciable property acquired from 1 April 2005 other than: buildings, fixed life intangible property, excluded depreciable property, and property for which the rate is set under ss EE 29 or EE 30.</td>
<td>EE 27</td>
<td>250.230</td>
</tr>
<tr>
<td>Buildings acquired from 19 May 2005 for which the economic depreciation rate is not set under s EZ 23.</td>
<td>EE 28</td>
<td>250.240</td>
</tr>
<tr>
<td>Certain aircraft and motor vehicles acquired from 1 April 2005.</td>
<td>EE 29</td>
<td>250.250</td>
</tr>
<tr>
<td>Items that have an estimated residual market value greater than 13.5 per cent of their cost, and would otherwise have an economic depreciation rate set under ss EE 27 or EE 28.</td>
<td>EE 30</td>
<td>250.630</td>
</tr>
<tr>
<td>Property of the following kinds:</td>
<td>EZ 23</td>
<td>250.630</td>
</tr>
<tr>
<td>(i) Depreciable property acquired before 1 April 2005 other than buildings, fixed life intangible property or excluded depreciable property;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) Buildings acquired before 19 May 2005;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Buildings acquired from 19 May 2005, as relationship property or from a company in the same wholly-owned group of companies, from a person who applied to the building an economic depreciation rate set under s EZ 23 or corresponding provision.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

An economic depreciation rate must not be set for fixed life intangible property [see 250.370] or excluded depreciable property [see 250.660]. The CIR has issued a determination [Depreciation Determination DEP54] setting the economic depreciation rates for property of the types referred to in ss EE 27 and EE 28 [items (a) and (b) above].
250.230  **Depreciation rate for property other than buildings** [s EE 27]

The economic depreciation rate for depreciable property acquired from 1 April 2005 (excluding buildings, fixed life intangible property, excluded depreciable property, and property for which the rate is set under ss EE 29 or EE 30), is calculated by the CIR using the procedure set out below. To set the rate, the CIR issues a determination under s 91AAF of the TAA. The CIR issued the first such determination [see Depreciation Determination DEP54] on 27 April 2006. A large number of other depreciation determinations have since been issued.

The formula for calculating the diminishing value rate is:

\[
\frac{2}{\text{estimated useful life}}
\]

“Estimated useful life” is the estimated useful life of the property expressed in years.

The estimated useful life for an item of depreciable property, other than a copyright in a sound recording, is the period over which the item might reasonably be expected to be useful in deriving assessable income or carrying on a business for the purpose of deriving assessable income, taking into account:

(a)  The passage of time, likely wear and tear, exhaustion and obsolescence; and

(b)  An assumption of normal and reasonable maintenance.

The estimated useful life of a copyright in a sound recording is the period from the time at which the copyright is first useful in deriving assessable income until the end of the income year in which it might reasonably be expected that 90 per cent of all the income that will be derived from it has been derived [s EE 63].

Example:
The estimated useful life of a personal computer is four years (as per the IR265). The DV rate is two divided by four, or 50 per cent. The equivalent SL rate is 40 per cent.

The figure calculated under the above formula is then rounded up or down to the nearest rate specified in sch 11 (banded rates of depreciation), column 1. Under Determination DEP54, the CIR has set the following banded rates of depreciation for items with the estimated useful lives shown:

<table>
<thead>
<tr>
<th>Estimated useful life (years)</th>
<th>DV banded depreciation rate</th>
<th>SL equivalent banded depreciation rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>2%</td>
<td>1.5%</td>
</tr>
<tr>
<td>50</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>33.3</td>
<td>6%</td>
<td>4%</td>
</tr>
<tr>
<td>25</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>20</td>
<td>10%</td>
<td>7%</td>
</tr>
<tr>
<td>15.5</td>
<td>13%</td>
<td>8.5%</td>
</tr>
<tr>
<td>12.5</td>
<td>16%</td>
<td>10.5%</td>
</tr>
<tr>
<td>10</td>
<td>20%</td>
<td>13.5%</td>
</tr>
<tr>
<td>8</td>
<td>25%</td>
<td>17.5%</td>
</tr>
<tr>
<td>6.66</td>
<td>30%</td>
<td>21%</td>
</tr>
<tr>
<td>5</td>
<td>40%</td>
<td>30%</td>
</tr>
<tr>
<td>4</td>
<td>50%</td>
<td>40%</td>
</tr>
<tr>
<td>3</td>
<td>67%</td>
<td>67%</td>
</tr>
<tr>
<td>2</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>1</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

**Note:** The economic depreciation rate was increased by 20 per cent if the item (other than buildings) was acquired new before 21 May 2010 [see 250.270].

(1)  **Meaning of “obsolescence”**

The CIR’s view on the meaning of the term “obsolescence” in the context of an item’s estimated useful life under s EE 63 is set out in interpretation statement IS 11/01 [TIB vol 23:6 (July 2011) at 6–16]. Obsolescence...
Depreciation

involves a reduction in the period for which an item might be expected to be useful in deriving assessable income for reasons such as economic, technological or other external causes that affect the estimated useful life of the item. Obsolescence will cause an item to no longer be useful in deriving assessable income before the end of its physical life.

Whether an item is affected by obsolescence is a question of fact to be judged objectively. An item will be obsolete if causes external to that item, and outside the control of the taxpayer, will result in it being no longer useful in deriving assessable income before the end of its physical life. For obsolescence to affect the estimated useful life of an item there must be a reasonable certainty that it will become obsolete and a sufficiently clear indication of when this would be likely to occur. The nature of obsolescence can be described in the following terms:

• Obsolescence is the process whereby an item loses its economic usefulness or ability to function in a business through causes other than physical deterioration or wear and tear.
• Obsolescence may arise from factors that are inherent in the item (functional obsolescence) or that constitute a change to the environment or conditions surrounding an item (economic obsolescence).
• Obsolescence may arise from changes in the way the business is undertaken, shifting of business centres, loss of trade, technological changes, new inventions, inadequacy, and prohibitory laws.
• Obsolescence may arise from technological changes or the development of more modern improved alternatives that are significant enough to affect the useful life of an item and mean that the item has been superseded by improvements.

The following are examples of external causes that may result in an item becoming obsolete:

• Prohibitory laws or regulatory changes;
• Technological changes;
• Changes in consumer tastes and public opinion;
• Changes in the way in which a business or a type of business is undertaken;
• Depletion of raw materials on which the item is reliant to produce income;
• The item causes reduced ability or failure to continue business at previous levels.

Any reasonably predictable obsolescence that reduces the estimated useful life of the item will be taken into account at that time the CIR sets the estimated useful life for an item of depreciable property.

A decrease in the estimated useful life of an item as a result of the following factors is not considered to be caused by obsolescence:

• Demolition, scrapping or abandonment of the item, or a decision to do so;
• A decision of management to discontinue the use of an item;
• The availability of newer or better alternatives;
• Market forces of supply and demand;
• A desire to enhance or expand business operations;
• The likelihood of business failure.

250.240 Depreciation rate for buildings [s EE 28]

(1) No depreciation of buildings from the 2011–2012 income year

From the 2011–2012 income year, no depreciation can be claimed on buildings with an estimated useful life of 50 years or more. Buildings with an estimated useful life of less than 50 years can continue to be depreciated at the appropriate SL or DV rate. See 250.270 for further details.

(2) Setting depreciation rates for buildings

The economic depreciation rate for buildings is calculated by the CIR using the procedure set out below. This method does not apply if the economic depreciation rate is set under s EE 30 (items with high residual value) or s EZ 23 (buildings acquired before 19 May 2005) [see 250.630]. To set the rate, the CIR issues a determination under s 91AAF of the TAA.

The meaning of the term “building” is explained in 250.310.
Depreciation

The formula for calculating the straight-line rate is:

\[
\text{rate} = \frac{1}{\text{estimated useful life}}
\]

“Estimated useful life” is the estimated useful life of the property expressed in years [see 250.230].

Example:
A building has an estimated useful life of 33.3 years (as per the IR265). The SL rate is one divided by 33.3, or three per cent. The equivalent DV rate is five per cent.

The figure calculated under this formula is then rounded up or down to the nearest rate specified in sch 11 (banded rates of depreciation), column 4 (SL banded depreciation rate). Under Determination DEP54, the CIR has set the following banded rates of depreciation for items with the estimated useful lives shown:

<table>
<thead>
<tr>
<th>Estimated useful life (years)</th>
<th>DV equivalent banded depreciation rate</th>
<th>SL banded depreciation rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>1.3%</td>
<td>1%</td>
</tr>
<tr>
<td>50</td>
<td>3%</td>
<td>2%</td>
</tr>
<tr>
<td>33.3</td>
<td>4.5%</td>
<td>3%</td>
</tr>
<tr>
<td>25</td>
<td>6.5%</td>
<td>4%</td>
</tr>
<tr>
<td>20</td>
<td>8.5%</td>
<td>5%</td>
</tr>
<tr>
<td>15.5</td>
<td>11%</td>
<td>6.5%</td>
</tr>
<tr>
<td>12.5</td>
<td>13.5%</td>
<td>8%</td>
</tr>
</tbody>
</table>

Note: A building acquired under a binding contract for purchase or construction entered into before 19 May 2005 must be depreciated using the economic depreciation rate determined under s EZ 23.

250.250 Depreciation rate for certain aircraft and motor vehicles [s EE 29]

(1) Aircraft
The economic rate of depreciation for an aircraft is 10 per cent DV or seven per cent SL if the aircraft:
(a) Is self-propelled;
(b) Has fixed wings;
(c) Is not an international aircraft;
(d) Is not used for top-dressing or spraying; and
(e) Is not a helicopter.

Note: The annual depreciation rate for an “international aircraft” is 15 per cent DV or 10 per cent SL [s EE 31(2)(c), 250.260].

(2) Motor vehicles
The economic rate of depreciation for a motor vehicle that is designed exclusively or mainly to carry people, and has seats for no more than 12 people, is 30 per cent DV or 21 per cent SL if the motor vehicle is:
(a) Not available for hire;
(b) Available for hire for a period of more than one month;
(c) A taxi; or
(d) A minibus.
250.260 **Depreciation rate for international aircraft** [s EE 31(2)(c), (3)(b)]

The annual rate for international aircraft acquired in the 1995–1996 or later income year is 15 per cent DV or 10 per cent SL. “International aircraft” means a jet-engined aircraft that a person uses mainly in regular commercial service to transport passengers between New Zealand and any other place [s EE 67].

250.270 **Depreciation rates for property acquired in the 1995–96 income year or later** [ss EE 31, EE 61(2)]

The annual rate for depreciable property acquired in the 1995–1996 or later income year depends on whether the property was acquired before or after 20 May 2010.

(1) **Depreciable property acquired on or before 20 May 2010**

The annual rate for the item is the applicable rate set out in the table below, if the person:

(a) Acquires the item on or before 20 May 2010; or

(b) Decides to purchase or construct the item, meets the administrative requirements, and:

(i) Enters into a binding contract for the purchase or construction of the item on or before 20 May 2010; or

(ii) After deciding to purchase or construct the item, incurs expenditure for its purchase or construction on or before 20 May 2010.

In order to meet the administrative requirements, the person must:

(a) Have available for the CIR documents dated on or before 20 May 2010 that evidence that the person had, on or before 20 May 2010, decided to purchase or construct the relevant item; or

(b) Send to the CIR a statutory declaration that the person had, on or before 20 May 2010, decided to purchase or construct the relevant item.

<table>
<thead>
<tr>
<th>Type of property</th>
<th>Annual rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings (before the 2011–2012 income year)</td>
<td>Economic rate, special rate or provisional rate</td>
</tr>
<tr>
<td>Buildings with an estimated useful life of 50 years or more (from the 2011–2012 income year)</td>
<td>0%</td>
</tr>
<tr>
<td>Buildings with an estimated useful life of less than 50 years (from the 2011–2012 income year)</td>
<td>Economic rate, special rate or provisional rate</td>
</tr>
<tr>
<td>Used imported cars</td>
<td>Economic rate, special rate or provisional rate</td>
</tr>
<tr>
<td>International aircraft</td>
<td>15% DV or 10% SL [see 250.260]</td>
</tr>
<tr>
<td>Property that has been used or held for use in New Zealand as an item of depreciable property before the date on which the person acquires it (ie secondhand property)</td>
<td>Economic rate, special rate or provisional rate</td>
</tr>
<tr>
<td>Property not described above</td>
<td>Economic rate, special rate or provisional rate, increased by 20%</td>
</tr>
</tbody>
</table>

Note: From the 2011–2012 income year, no depreciation can be claimed on buildings with an estimated useful life of 50 years or more.

The economic rates are listed in 5000 DEPRECIATION RATES.

(2) **Depreciable property acquired after 20 May 2010**

The annual rate for the item is the applicable rate set out in the table below, if the person:

(a) Acquires the item after 20 May 2010; or
Depreciation

(b) Decides to purchase or construct the item, and:
   (i) Enters into a binding contract for the purchase or construction of the item after 20 May 2010; or
   (ii) Incurs expenditure for its purchase or construction after 20 May 2010.

Type of property | Annual rate
--- | ---
Buildings with an estimated useful life of 50 years or more (from the 2011–2012 income year) | 0%
International aircraft | 15% DV or 10% SL [see 250.260]
Property not described above | Economic rate, special rate or provisional rate

Note:
1. The 20 per cent loading does not apply to any item of depreciable property acquired, or for which a binding contract is entered into for purchase or construction, after 20 May 2010.
2. From the 2011–2012 income year, no depreciation can be claimed on buildings with an estimated useful life of 50 years or more. This applies whether the building was acquired before or after 20 May 2010.

The economic rates are listed in 5000 Depreciation Rates.

(3) Property not covered by annual rates

The economic rates do not apply to fixed life intangible property or excluded depreciable property, for which the rates are set as explained in 250.370 and 250.660 respectively.

The economic rates also do not apply to property deemed to be acquired under s FL 2(2) when a company emigrates from New Zealand [see 170.65].

(4) Depreciable buildings

Buildings with an estimated useful life of less than 50 years, and for which depreciation at the economic rate can be claimed, are listed below. Refer to the CIR’s table of rates (IR 265) for the relevant estimated useful life and economic rate. The meaning of “building” for depreciation purposes is explained in 250.310.

(a) Buildings and Structures asset category:
   • Barns;
   • Buildings (portable) (if deemed to be sufficiently permanent);
   • Buildings with prefabricated stressed-skin insulation panels;
   • Chemical works;
   • Fertiliser work;
   • Fowl houses;
   • Hothouses;
   • Pig houses;
   • Shade houses;
   • Tanneries.

(b) Agriculture, Horticulture and Aquaculture industry category:
   • Dairy sheds and yards

(c) Dairy Plant industry category:
   • Powder dryer buildings

(d) Cigarette Manufacturing industry category
   • Barns (drying)
Selecting the depreciation rate

The following points must be considered when choosing the appropriate depreciation rate for an asset:

(a) The date of the asset’s acquisition;

(b) All property is either depreciable property or not depreciable property;

(c) All depreciable property is:
   (i) Fixed life intangible property;
   (ii) Excluded depreciable property acquired before 1 April 1993;
   (iii) Depreciable property acquired between 1 April 1993 and the end of the 1994–1995 income year (both dates inclusive);
   (iv) Depreciable property acquired between the start of the 1995–1996 income year and 31 March 2005 (18 May 2005 in the case of buildings);
   (v) Depreciable property acquired from 1 April 2005 (19 May 2005 in the case of buildings); or
   (vi) Buildings with an estimated useful life of 50 years or more, including special excluded depreciable property (with effect from the 2011–2012 income year).

(d) Each classification of assets has its own particular depreciation rates that depend on the type of asset.

Choosing the appropriate depreciation rate

The following flowchart summarises the rules for determining the appropriate depreciation method and rate for an asset. The flowchart must be read in conjunction with the relevant section or definition in the ITA 2007.
The "new" economic depreciation rates are listed in 5000 DEPRECIATION RATES. See also Inland Revenue booklets Depreciation – A guide for businesses (IR260) and General depreciation rates (IR265).
Rates for assets purchased before the end of the 1994–1995 income year are as follows:

<table>
<thead>
<tr>
<th>Date of purchase of asset</th>
<th>Depreciation rates to use</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 December 1991 and earlier</td>
<td>Historic rates</td>
</tr>
<tr>
<td>16 December 1991 to 31 March 1993</td>
<td>Historic rates (plus 25% uplift if applicable)</td>
</tr>
<tr>
<td>1 April 1993 to the end of the 1994–1995 income year</td>
<td>Either the historic rates (plus 25% uplift if applicable), or the old economic rates.</td>
</tr>
</tbody>
</table>

The historic rates are the depreciation rates that applied to assets acquired before 31 March 1993. The old economic rates are the original economic rates set by Inland Revenue and which applied to assets acquired between 1 April 1993 and the end of the 1994–1995 income year. Both the historic rates and the old economic rates are listed in the Inland Revenue publication *Historic depreciation rates* IR 267.

### 250.290 Special rates

#### (1) Applying for a special rate

A person may apply for a special rate if they consider that the economic rate is not appropriate to their circumstances, eg if they use an item of depreciable property more or less intensively than normal. A special rate may be higher or lower than the economic rate for the item. Application for a special rate must be made in writing to the CIR (on form IR 260B) [TAA, s 91AAG(1)].

Within six months of receiving an application for a special rate, the CIR must either issue, or decline to issue, the determination. However, the applicant may agree to an extension of the six-month time limit. Within 30 days of issuing or deciding not to issue a determination, the CIR must give the applicant (or the applicant’s representative) notice of the decision and either a copy of the determination or the reasons for declining it [TAA, s 91AAM].

A special rate may not be set for an item of excluded depreciable property (see 250.660). In addition, from 20 May 2010, a special rate may not be set for an item of special excluded depreciable property or a building [s EE 35(2), see 250.670].

#### (2) CIR’s process

The CIR’s process for issuing a determination is to:

- Prepare a draft determination and send it to the applicant;
- Hold a conference to discuss the determination with the applicant (optional); and
- Issue the determination.

When determining whether or not to grant an application for a special rate, the level of any such rate, and the income year or years to which it applies, the CIR may have regard to any factors that are relevant in determining the item’s estimated useful life, including an estimate based on a depreciation method or on a valuer’s report, or a rate of depreciation that the person uses for the item for financial reporting purposes [TAA, s 91AAG(2)].

A special rate may be either a DV rate or a SL rate. A special rate is set by the CIR using the applicable formula in ss EE 27, EE 28, EE 30 or EZ 23, or using the straight-line method [TAA, s 91AAG(3)].

The term of a lease is not a relevant factor in determining an item’s estimated useful life for the purposes of setting a special rate. For example, the fact that an item of depreciable property is located inside a leased building is not relevant in determining the estimated useful life of the item when setting a special rate. See Inland Revenue interpretation statement IS 10/05.
(3) **Dispute or challenge**
A person who has applied for a determination setting a special rate may dispute or challenge the determination [TAA, s 91AAJ].

(4) **CIR may decline to issue determination**
The CIR may decline to issue a special rate if:

(a) The difference between the economic rate for the item and an appropriate special rate would be less than 50 per cent of the difference between the already applicable economic rate and the next higher or lower rate (as applicable) in sch 11 (for items acquired on or after 1 April 2005) or sch 12 (for items acquired before 1 April 2005);

(b) The CIR is reviewing the economic rate for the item and intends to set a new economic rate that is equal to or more than an appropriate special rate within six months of the date of the application; or

(c) The applicant has supplied insufficient information to enable the CIR to calculate an appropriate rate [TAA, s 91AAH(2)].

| Example: |
The economic rate set for an item of depreciable property is 20 per cent DV. The next highest DV band is 25 per cent. A special rate application will therefore have to produce a rate of at least 23 per cent under the formula in s EE 26 before the special rate determination is issued.

(5) **Revocation**
The CIR may revoke a determination that sets a special rate for an item, or revoke the determination and set a new special rate, if the circumstances that applied at the time the original determination was issued no longer exist or have changed materially. If the CIR revokes a determination without issuing a new one, the person must depreciate the item using the economic rate or an applicable provisional rate. A revocation takes effect from the day after the date the person is notified, or the day after the date notice is published in the Gazette [TAA, s 91AAI].

Within 30 days of revoking the determination, the CIR must notify the applicant (or the applicant’s representative) of the decision and the reasons for revoking the determination [TAA, s 91AAM(5), (6)].

(6) **Using a special rate**
A person may depreciate an item to which a special rate applies by applying, instead, the economic rate or a provisional rate applicable to the item. However, if a special rate applies to an item, the economic rate or the provisional rate cannot be used if:

(a) The special rate is higher than the economic rate;

(b) The person applies the special rate to the item for an income year;

(c) In a later income year, the item’s market value declines at a rate equal to or greater than the special rate; and

(d) It can reasonably be concluded from all the circumstances that the person’s purpose, or one of their purposes, in wanting to change from the special rate to the economic rate or the provisional rate is to enable the person to defer the depreciation deduction [s EE 36].

For certain operating leases, for income years commencing after 20 June 2007, the depreciation allowed for a lease asset is five-sixths of the depreciation otherwise allowable [see 900.30].

(7) **Property previously used other than for business purposes**
When a taxpayer applies for a special rate for an item of depreciable property that was previously used for a purpose other than deriving assessable income or carrying on a business (for example, a secondhand imported asset or an asset previously used for private purposes), it is the CIR’s policy that, in determining the special rate, the estimated useful life of the item will be interpreted as the total useful life of the item, not the remaining...
useful life. In other words, the estimated useful life is not reduced by the period during which the item was not used for income generating or business purposes.

The following examples illustrate how this policy will apply in practice.

**Example 1:**
Company A imports a secondhand machine into New Zealand. The machine is 15 years old, and is expected to be useful in New Zealand for a further four years. It will then cease to comply with New Zealand safety standards, and so will be scrapped or sold offshore. No unusual factors will cause it to deteriorate faster than normal. The estimated useful life of the machine is 19 years, being the total number of years that the machine could potentially be expected to be useful for deriving income or carrying on a business. The machine could potentially have been used for deriving income or carrying on a business in New Zealand during its entire life, even though it was actually outside New Zealand for its first 15 years.

**Example 2:**
Company B purchases a secondhand item of depreciable property in New Zealand. The item was previously used privately for five years, and it will be used by Company B for another three years before it is scrapped. The item would normally last for another five years, but the way that the company uses it will cause it to deteriorate within three years of acquisition. The estimated useful life of the item is eight years. This includes the five years that the item was used privately as it might reasonably have been expected to be useful in a business in New Zealand during this period. The eight year estimated useful life also takes into account the abnormal use of the item by Company B which causes it to lose value faster than normal (normally that type of item would have an estimated useful life of 10 years).

**250.290(8) Depreciation**

(8) Objections to determinations of special rates [TAA, ss 91AAJ]

Any taxpayer who has applied for a determination for a special rate and any taxpayer to whom such a determination applies, may dispute or challenge the determination in accordance with Part 4A and Part 8A of the TAA.

**250.300 Provisional rates [ss EE 35, EE 36; TAA, ss 91AAG, 91AAH, 91AAJ, 91AAM]**

(1) Applying for a provisional rate

A person may apply for a provisional rate if there is no applicable economic rate for an item of depreciable property. This may apply, for example, to a type of property that has not been used in New Zealand previously. Application for a provisional rate must be made in writing to the CIR (on form IR 260A) [TAA, s 91AAG(1)].

A provisional rate may not be set for an item of fixed life intangible property or an item of excluded depreciable property [s EE 35(3)].

Within six months of receiving an application for a provisional rate, the CIR must either issue, or decline to issue, the determination. However, the applicant may agree to an extension of the six-month time limit. Within 30 days of issuing or deciding not to issue a determination, the CIR must give the applicant (or the applicant’s representative) notice of the decision and either a copy of the determination or the reasons for declining it. The CIR must also, within 30 days of issuing or revoking a determination that is expressed to apply to a class of persons, publish a notice in a publication chosen by the CIR giving notice that the determination has been issued and stating where copies can be obtained [TAA, s 91AAM].

(2) CIR’s process

The CIR’s process for issuing a determination is to:

(a) Prepare a draft determination and send it to the applicant;
(b) Hold a conference to discuss the determination with the applicant (optional); and
(c) Issue the determination.

When determining whether or not to grant an application for a provisional rate, the level of any such rate, and the income year or years to which it applies, the CIR may have regard to any factors that are relevant in determining the item’s estimated useful life, including an estimate based on a depreciation method or on a
A provisional rate may be either a DV rate or a SL rate. A provisional rate is set by the CIR using the applicable formula in s EE 27, EE 28, EE 30 or EZ 23, or using the SL method [TAA, s 91AAG(3)]. The rate calculated under the applicable formula must be rounded up or down to the nearest rate specified in schs 11 or 12 [TAA, s 91AAG(4)].

A determination setting a provisional rate for an item and a person may also be expressed to apply to items of the same kind as the item, and to any other person or class of persons [TAA, s 91AAG(5)]. If a provisional rate determination is stated to apply to a class of persons the CIR must, within 30 days of issuing the determination, give notice in the Gazette that the determination has been issued and stating where copies can be obtained [TAA, s 91AAM(4)].

A provisional rate for an item will usually apply to all taxpayers that own and use that class of item. However, a provisional rate may be limited to a class of taxpayers, for example, if the item is used in an atypical way by a particular industry group. A provisional rate can also be set for a specific taxpayer.

(3) **Determination ceasing to apply**

A determination setting a provisional rate ceases to apply when an economic rate for the item comes into force, unless the determination specifically provides otherwise [TAA, s 91AAG(6)].

(4) **Dispute or challenge**

A person who has applied for a determination setting a provisional rate may dispute or challenge the determination [TAA, s 91AAJ].

(5) **CIR may decline to issue determination**

The CIR may decline to issue a provisional rate if:

(a) An economic rate, other than a default rate, already applies to the item;

(b) A default rate applies to the item, and the difference between the default rate and the provisional rate would be less than 50 per cent of the difference between the default rate and the next higher or lower rate (as applicable) in sch 11 (for items acquired on or after 1 April 2005) or sch 12 (for items acquired before 1 April 2005);

(c) The CIR is in the process of determining an economic rate for the item for the income year to which the application relates and intends to set it within six months of the date of the application; or

(d) The person has supplied insufficient information to the CIR to calculate an appropriate rate [TAA, s 91AAH(3)].

(6) **Revocation**

The CIR may revoke a provisional determination if it no longer applies to an item or if the item is no longer in use or available for use. The revocation takes effect on the day after notification in the Gazette [TAA, s 91AAG(7)].

Within 30 days of revoking the determination, the CIR must notify the applicant (or the applicant’s representative) of the decision and the reasons for revocation [TAA, s 91AAM(5), (6)].

(7) **Using a provisional rate**

In some circumstances, a person may not depreciate an item using the provisional rate if a special rate applies to the item. See 250.290.

For certain operating leases, for income years commencing after 20 June 2007, the depreciation allowed for a lease asset is five-sixths of the depreciation otherwise allowable [see 900.30].
(8) Objections to determinations of provisional rates [TAA, ss 91AAJ]

Any taxpayer who has applied for a determination for a provisional rate and any taxpayer to whom such a determination applies, may dispute or challenge the determination in accordance with Part 4A and Part 8A of the TAA.

250.310 Meaning of “building” for depreciation purposes

There are specific provisions in the ITA 2007 that deal with the depreciation of buildings. In particular, the depreciation rate for new buildings is not increased by the 20 per cent loading that applies to most other newly acquired items acquired before 20 May 2010 [s EE 31(2)(b)(ii)]. From the 2011–2012 income year, no depreciation can be claimed on buildings with an estimated useful life of 50 years or more [s EE 31(2)(d), (3)(c)].

The term “building” is not defined in the legislation, although it does exclude grandparented structures and commercial fit-outs [s YA 1]. To clarify the meaning, the CIR issued an interpretation statement (IS 10/02) setting out the meaning of the term “building” in the context of the depreciation provisions. The statement applies from 30 July 2009. Since the interpretation statement was issued, Inland Revenue has revised the depreciation rates (see Determination DEP79) relating to buildings and other structures to reflect its modified view of what a building is.

The CIR’s view is that, in the context of the tax depreciation provisions, a building is an item within the ordinary or conventional meaning of the term “building”. Case law indicates that a building within the ordinary or conventional meaning of that term generally has the following characteristics:

- It is a structure of considerable size;
- It is permanent in the sense that it is intended to last a considerable time;
- It is permanent in the sense that it is designed to be located permanently on the site where it stands. A building is fixed to the land on which it stands. However, a building need not be legally part of the land on which it stands;
- It is enclosed by walls and a roof;
- It can function independently of any other structure. However, a building is not necessarily a physically separate structure.

The design of a building and the materials used to construct a building need to be of a kind that are intended to last for a considerable period.

The appearance and function of a structure are relevant in determining whether it is a building for depreciation purposes, that is, whether the structure looks like the conventional idea of a building and is designed for the uses to which conventional buildings are ordinarily put. It is appropriate to ask whether a reasonable person would regard the structure as a building.

It is the CIR’s view that the ordinary or conventional meaning of “building” is not modified for the purposes of the depreciation provisions either in terms of being broader, to include many built structures, nor to exclude buildings that provide a specialised function or purpose, or are integrated with plant. In the case of the latter group, for some such buildings (“temporary buildings”) s DB 20 provides concessionary treatment by allowing deductions for losses incurred on the destruction of the building. This concessionary treatment would also be available for some buildings that have shorter economic useful lives than buildings in general or are situated at construction sites.

250.320 Land and buildings [s EE 7]

Depreciation cannot be claimed on land [s EE 7(a)]. When land and improvements are purchased and the purchase price does not specify the cost of the improvements it will be necessary to objectively determine the portion of the purchase price that relates to the improvements. While an appropriately qualified valuer could be employed for this purpose, the Ratings Valuation (RV), prepared by Quotable Value [see www.qv.co.nz] provides acceptable and readily accessible information that can be used to apportion the purchase price between the land and the improvements, as follows:

\[(\text{RV of improvements} / \text{RV of land and improvements}) \times \text{purchase price of land and buildings}\]
Depreciation

Example:
A small medical practice purchased a residential property to use as its business premises. The purchase price of the property was $500,000. The most recent ratings valuation indicated that the property had a capital value (total value) of $520,000 and a land value of $295,000. The value of the building itself (i.e., the improvements) is therefore $225,000. The proportion of the purchase price that relates to the building is calculated as follows:

\[
\frac{225,000}{520,000} \times 500,000 = 216,346
\]

250.330 Depreciable land improvements [sch 13]

While land is specifically excluded from the definition of depreciable property, certain land improvements can (from 1 April 1993, unless stated otherwise) be depreciated:

- Airport runways;
- Bores and wells;
- Bridges;
- Chimneys;
- Culverts;
- Dams;
- Fences;
- Hardstanding;
- Pipes (from 2008–2009);
- Purpose-built surfaces for outdoor sports facilities (from 2008–2009);
- Reservoirs;
- Retaining walls;
- Roads;
- Spillways;
- Swimming pools;
- Tanks;
- Tunnels;
- Wharves.

Land improvements made for the purposes of farming, agriculture, aquaculture and forestry can be amortised if the improvements are of a type set out in sch 20 [ss DO 4, DO 12, DP 3, see 430.130, 500.30 and 520.40].

250.340 Building fit-out not separately depreciated [s DB 65]

Depreciation cannot be claimed on buildings with an estimated useful life of 50 years or more from the 2011–2012 income year [250.240, 250.270]. However, commercial building owners who did not separately identify and depreciate building fit-out at the time of acquisition are still able to amortise a portion of the building’s adjusted tax value (as at the start of the 2011–2012 income year) until the building is disposed of. Items of building fit-out that were acquired after the building was acquired and that have been separately depreciated are excluded from the building’s adjusted tax value.

A person who meets all of the criteria (a) to (f), as set out below, for an income year is treated as having a loss equal to the amount calculated by the following formula:

\[
\text{Starting pool} \times 0.02 \times (\text{whole months}/12)
\]

Where:

“Starting pool” is calculated as:

\[
(0.15 \times \text{building atv}) - \text{fit-out atv}
\]

Where:

“Building atv” is the adjusted tax value of the building at the end of the 2010–2011 income year.
Depreciation

“Fitout atv” is the total adjusted tax value, at the end of the 2010–2011 income year, of all items of commercial fit-out that relate to the building, that were acquired after the building was acquired, and for which the person has claimed a depreciation deduction.

“Whole months” is the number of whole months in the income year in which the building is used, or is available for use, by the person in deriving assessable income or carrying on a business for the purpose of deriving assessable income.

The total of all deductions allowed under s DB 65 may not exceed the value of the starting pool. If the amount calculated under the first formula above exceeds the starting pool reduced by all deductions allowed in all previous income years, the lower figure is treated as the deductible amount.

The criteria that must be satisfied for an income year in order to claim a deduction under s DB 65 are:

(a) A person owns a commercial building, which is depreciable property and has an annual rate of zero per cent (ie the building has an estimated useful life of 50 years or more). (A “commercial building” is a building that is not, in part or in whole, a dwelling, unless use as a dwelling is a secondary and minor use);

(b) The “starting pool” for the building is greater than the total of all deductions allowed under s DB 65 in all income years before the current income year;

(c) The person was allowed a depreciation deduction for the building for the 2010–2011 income year and the person has not since disposed of the building;

(d) The person has never had a depreciation deduction for a separate item of depreciable property that is commercial fit-out, and that relates to the building and was acquired at the same time as the building;

(e) The building was acquired in the 2010–2011 or an earlier income year; and

(f) The person is not allowed a deduction under any other provision in relation to the building, for the income year.

The capital limitation does not apply to a loss under s DB 65 merely because the item of property is itself of a capital nature.

250.350 Residential rental properties

(1) Media release

In May 2006, Inland Revenue advised residential rental property owners that it is unacceptable for them to separate out the smaller components of their properties in order to be able to take advantage of higher depreciation rates for tax purposes. Chattels such as carpets, drapes, light fittings and whiteware, as well as water heaters, clotheslines and other fittings that are not part of the building, can be separately depreciated. However, items such as internal walls, doors, electrical wiring, plumbing, and furniture and fittings such as kitchen cupboards, bathroom vanities and built-in wardrobes, which are permanently attached to or are part of the building, cannot be depreciated separately. Prior to the media release, it had been the practice of some residential rental property owners to split these components out and depreciate them separately at depreciation rates listed in the asset category “Building fit-out (when in the books separately from building cost)”. Inland Revenue advised that property owners who have done this will have overstated their depreciation claims in the past, but won’t be required to adjust previous years’ income. However, they will be required to add the value of the various components back to the cost of the building for future depreciation purposes [see Inland Revenue Media release, 29 May 2006].

(2) CIR’s 2010 interpretation statement

The CIR’s view on how to determine whether an item that forms part of a residential rental property is a separate item of depreciable property, or is part of the building, is set out in interpretation statement IS 10/01 (TIB vol 22:4 (May 2010), at 16–47). The statement concludes that the following three-step process should be followed to determine whether a particular item is part of or separate from the building:

Step 1: Determine whether the item is in some way attached or connected to the building. If the item is completely unattached, then it will not form a part of the building. An item will not be considered attached...
for these purposes if its only means of attachment is being plugged or wired into an electrical outlet (such as a freestanding oven), or attached to a water or gas outlet. If the item is attached to the building, go to step 2.

**Step 2:** Determine whether the item is an integral part of the residential rental property such that a residential rental property would be considered incomplete or unable to function without it. If the item is an integral part of the residential rental property, then the item will be a part of the building. If the item is not an integral part of the residential rental property, go to step 3.

**Step 3:** Determine whether the item is built-in or attached or connected to the building in such a way that it is part of the “fabric” of the building. Consider factors such as the nature and degree of attachment, the difficulty involved in the item’s removal, and whether there would be any significant damage to the item or the building if the item were removed. If the item is part of the fabric of the building, then it is part of the building for depreciation purposes.

Applying this approach, the statement concludes that plumbing and piping, electrical wiring, internal walls, internal and external doors, garage doors (when the garage is part of the residential rental building), fitted furniture (wardrobes and cupboards built into the wall), kitchen cupboards, bathroom fittings and furniture, linoleum, and tiles (wall and floor) are not separate assets, but are part of the building. Wardrobes and cupboards not built into the wall, carpets, curtains, blinds and water heaters and hot-water cylinders can be regarded as separate from the building, so can be depreciated at a different rate.

### 250.360 Depreciable intangible property [ss EE 33, EE 43, EE 62, EE 67]

Depreciable intangible property can be depreciated [s EE 6(3)]. Depreciable intangible property is defined as property listed in sch 14, namely:

(a) The right to use a copyright.
(b) The right to use a design or model, plan, secret formula or process, or other like property or right.
(c) A patent or the right to use a patent.
(d) A patent application with a complete specification lodged from 1 April 2005.
(e) The right to use land.
(f) The right to use plant or machinery.
(g) The copyright in software, the right to use the copyright in software, or the right to use software.
(h) The right to use a trademark.
(i) Management rights and licence rights created under the Radiocommunications Act 1989.
(j) A consent granted under the Resource Management Act 1991 to do something that otherwise would contravene ss 12–15 of that Act (other than a consent for a reclamation), being a consent granted in or after the 1996–1997 tax year.
(k) The copyright in a sound recording, if the copyright was produced or purchased by the taxpayer from 1 July 1997 and copies of the recording have been sold or offered for sale to the public.
(l) Plant variety rights granted under the Plant Variety Rights Act 1987 or similar rights given similar protection under the laws of a country or territory other than New Zealand.
(m) A right to use plant variety rights granted under the Plant Variety Rights Act 1987 or a similar right under the laws of a country or territory other than New Zealand.

Under s EE 62(2) depreciable intangible property must meet the following criteria to be listed in sch 14:

(a) It must be intangible; and
(b) It must have a finite useful life that can be estimated with a reasonable degree of certainty on the date of its acquisition.

However, s EE 62(3) provides that property listed in sch 14 is depreciable property even if the criteria are not met. This provision overcomes some issues with the interpretation of the phrase “depreciable intangible property”. In short, if it is listed in sch 14 it is depreciable intangible property.
Although the right to use a trademark for a fixed period is depreciable intangible property, a trademark itself is not, and therefore cannot be, depreciated because it effectively has an unlimited life. Intangible property can only be depreciated if it has a finite and measurable useful life at the time of acquisition: *Trustees of CB Simkin Trust v Commissioner of Inland Revenue* [2003] 2 NZLR 315 (CA); *Trustees in the CB Simkin Trust v Commissioner of Inland Revenue* (2002) 20 NZTC 17,611 (HC).

Intangible property created or purchased after 31 March 1993 (and for which a deduction is not otherwise available) is depreciable. When a taxpayer develops intangible property rather than purchasing it, any scientific research costs may be deductible under s DB 33, or may qualify as expenditure on research and development under s DB 34.

(1) **Transfer of depreciable intangible property**

If a person (Person A) directly or indirectly acquires (on or after 1 July 1997) depreciable intangible property from an associated person, Person A is not allowed a depreciation loss for the property if it:

(a) Was not depreciable property of the associated person because it was not of a kind listed in sch 14 at the time it was acquired by the associated person; and

(b) Was not property the cost of which was allowed as a deduction to the associated person, other than a deduction for a depreciation loss, under a provision outside subpart EE [s EE 43].

**250.370 Fixed life intangible property** [s EE 33]

Fixed life intangible property that falls within the following categories will have its depreciation rate set under the provisions indicated, rather than under s EE 33:

(a) Excluded depreciable property [s EZ 15, see 250.660];

(b) A patent acquired in the 2005–2006 or later income year [s EE 34, see 250.390].

The depreciation rate for FLIPs is calculated using the following formula:

\[
\frac{1}{\text{legal life}}
\]

Where:

“Legal life” is:

(a) The number of years, months and days for which an owner’s interest in an item of intangible property exists under the contract or statute that creates the owner’s interest, assuming the owner exercises any rights of renewal or extension that are either essentially unconditional or conditional on the payment of predetermined fees;

(b) For patents acquired in the 2005–2006 or later income year, or patent applications first lodged from 1 April 2005, the legal life under (a) if the patent was granted when the patent application was first lodged;

(c) For plant variety rights granted in the 2005–2006 or later income year, the total of the legal life under (a) and the number of whole calendar months during which the person owns the plant variety rights application [s EE 67].

In determining the length of the legal life it must be assumed that any automatic rights of renewal are taken up, provided the only action needed is the payment of a predetermined fee.

For the purposes of the above formula, the legal life is taken to be the FLIP’s remaining legal life from the time at which the property was acquired. If the owner of the FLIP incurs additional costs in relation to the FLIP and a deduction for those costs (except as depreciation) is denied, the legal life is taken to be the FLIP’s remaining legal life from the start of the income year in which the additional costs were incurred [s EE 33(3)]. The additional costs are added to the FLIP’s adjusted tax value at the start of the income year.
The rate given by the formula is expressed as a decimal and rounded to two decimal places, with numbers at the midpoint or greater rounded up and other numbers rounded down. The formula gives an SL depreciation rate. The SL method is the only depreciation method that can be used for FLIPs. FLIPs are not eligible for the 20 per cent loading (prior to 21 May 2010) under s EE 31.

Example 1:
A patent for a new type of electric motor is purchased on 1 May 1999 for $100,000. The patent was granted on 1 May 1997 for an initial period of four years, with automatic rights of renewal that enable it to run to 1 May 2013 if it is renewed when required. As far as can be ascertained at the time of purchase, the patent remains valuable until the end of its legal life. The depreciation rate to be used by the purchaser is:

\[
\frac{1}{14} = 0.07 \text{ (or 7\%)}
\]

A $7,000 ($100,000 × 7\%) depreciation loss can therefore be claimed each year. If the patent becomes obsolete before the end of its legal life, the owner can apply to write off the remaining ATV value under the provisions of s EE 39.

Various adjustments must be made when a FLIP is sold, both for the vendor and purchaser.

Example 2:
On 1 October 20X1 Vanessa, who has a 31 March balance date, is granted a lease for three years at a premium of $3,000. The depreciation rate is 33.33 per cent SL. The depreciation allocated to each year is:

<table>
<thead>
<tr>
<th>Income Year</th>
<th>Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1–X2</td>
<td>$500</td>
</tr>
<tr>
<td>20X2–X3</td>
<td>$1,000</td>
</tr>
<tr>
<td>20X3–X4</td>
<td>$1,000</td>
</tr>
<tr>
<td>20X5–X6</td>
<td>$500</td>
</tr>
</tbody>
</table>

If on 1 April 20X2 Vanessa assigns the lease to Emma for a premium of $2,000, Vanessa’s deductions for the 20X1–X2 and 20X2–X3 years will be the same, but in the 20X3–X4 year an adjustment is necessary. It means that $500 is included in income, being the difference between the premium received $2,000 and the adjusted tax value $1,500 as at 31 March 20X3 [s EE 48]. Vanessa cannot claim any deduction in the 20X3–X4 and 20X4–X5 years.

Emma can claim depreciation on $2,000 at the rate of 66.67 per cent, which writes the item off over its remaining legal life.

<table>
<thead>
<tr>
<th>Income Year</th>
<th>Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X3–X4</td>
<td>$1,333</td>
</tr>
<tr>
<td>20X4–X5</td>
<td>$667</td>
</tr>
<tr>
<td></td>
<td>$2,000</td>
</tr>
</tbody>
</table>

250.380 Economic life intangible property
Depreciable intangible property which can be expected to have an economic life which is shorter than its legal life (economic-life intangibles), such as software, are not FLIPs. The CIR determines their depreciation rate (ie the economic rate) using the same method that is applied to all tangible depreciable property. See 5000 DEPRECIATION RATES.

Unlike FLIPs, economic-life intangibles can be depreciated using either a DV or SL depreciation rate. They can also be pooled, and are eligible for the 20 per cent loading under s EE 31 (for items acquired before 21 May 2010). Taxpayers can also apply for a special or provisional depreciation rate for economic-life intangibles.

250.390 Patents [ss DZ 15, EE 34]
The rate of depreciation applicable to a patent acquired in the 2005–2006 or later income year is calculated using the following formula:

\[
\frac{1}{\text{legal life}}
\]
Depreciation

“Legal life” is defined in s EE 67 [see 250.370]. For the purposes of s EE 34, the legal life of a patent is determined as follows:

<table>
<thead>
<tr>
<th>Circumstances</th>
<th>Legal life</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section EE 19 applies to the patent (see below).</td>
<td>The patent’s remaining legal life from the start of the income year in which the owner incurs additional costs for the patent.</td>
</tr>
<tr>
<td>Section EE 19 does not apply to the patent, and the owner has not been allowed</td>
<td>The patent’s remaining legal life from the time at which the owner acquires the patent.</td>
</tr>
<tr>
<td>a depreciation deduction for the patent application.</td>
<td></td>
</tr>
<tr>
<td>Section EE 19 does not apply to the patent, and the owner has been allowed a</td>
<td>The remaining legal life of the patent application from the start of the income year in which the patent application was acquired.</td>
</tr>
<tr>
<td>depreciation deduction for the patent application, and s EE 19 has not applied</td>
<td></td>
</tr>
<tr>
<td>to the patent application while the person has owned it.</td>
<td></td>
</tr>
<tr>
<td>Section EE 19 does not apply to the patent, and the owner has been allowed a</td>
<td>The remaining legal life of the patent application from the start of the income year in which the patent was acquired.</td>
</tr>
<tr>
<td>depreciation deduction for the patent application, and s EE 19 has applied to</td>
<td></td>
</tr>
<tr>
<td>the patent application while the person owned it.</td>
<td></td>
</tr>
<tr>
<td>Section EE 19 applies to a patent or patent application that meets the definition</td>
<td>Section EE 19 applies to a patent or patent application that meets the definition of fixed life intangible property [see 250.370] if the owner incurs additional costs in relation to the patent or patent application and the owner is denied a deduction for those additional costs other than a depreciation deduction.</td>
</tr>
<tr>
<td>of fixed life intangible property [see 250.370] if the owner incurs additional costs in relation to the patent or patent application and the owner is denied a deduction for those additional costs other than a depreciation deduction.</td>
<td></td>
</tr>
<tr>
<td>The rate calculated using the above formula is expressed as a decimal and rounded to two decimal places, with numbers at the midpoint or greater being rounded up and other numbers being rounded down.</td>
<td></td>
</tr>
<tr>
<td>For the rules applying to the depreciation of patent applications lodged before 1 April 2005, see 250.107 in Staples Tax Guide 2011 edition or earlier.</td>
<td></td>
</tr>
</tbody>
</table>

**250.400 Plant variety rights [s EE 25, sch 14]**

A grant of plant variety rights under the Plant Variety Rights Act 1987 gives the holder the exclusive right to produce for sale and to sell propagated material of the plant variety for a period of 20 or 23 years, depending on the type of plant. The legal life of a plant variety right begins on the date the right is granted. A plant variety receives provisional protection from the date the application for the right is made. Plant variety rights and the right to use plant variety rights (including similar rights under the law of another country or territory) are depreciable intangible property [see sch 14].

Depreciation is allowed in respect of plant variety rights granted, and rights to use plant variety rights acquired, in the 2005–2006 and subsequent income years. The depreciation rates for plant variety rights, which are fixed life intangible property, are determined under s EE 33 [see 250.370].

Depreciation cannot be claimed under s EE 33 for the period between the date an application for plant variety rights is lodged and the date the application is granted. However, a “catch-up” depreciation deduction is available where:

(a) Plant variety rights are granted to a person in their 2005–2006 or later income year;
(b) The rights are granted in relation to an application owned by that person; and
(c) A deduction for expenditure is not allowed under any provision other than s EE 25.

If these conditions are met, the person is allowed a deduction for expenditure on the plant variety rights application in the income year in which the plant variety rights are granted, calculated using the formula:

\[
\frac{\text{cost} \times \text{months of ownership}}{\text{depreciation months}}
\]

Where:
Depreciation

“Cost” is the cost of the plant variety rights application;
“Months of ownership” is the number of whole calendar months for which the person owns the plant variety rights application (ie the period between when the application is lodged and when it is granted);
“Depreciation months” is the total of the months of ownership (as above) and the number of months in the term for which the plant variety rights are granted.

Example:
Plant Breeders Ltd developed a new plant variety and applied for a plant variety right on 14 July 20X1. The cost of obtaining the plant variety right was $100,000. The company has a standard balance date. Provisional protection automatically applied from 14 July 20X1. The plant variety right was granted on 4 November 20X2 for a period of 20 years (240 months). The provisional protection period (from July 20X1 to October 20X2) is 16 months. Depreciation cannot be claimed until the income year in which the right is granted (ie the 20X2–X3 income year). In the 20X2–X3 income year the company can claim depreciation from November 20X2 to March 20X3 as follows:
$$5 \div (240 + 16) \times \$100,000 = \$1,953$$
In addition, Plant Breeders Ltd can claim catch-up depreciation for the period of provisional protection as follows:
$$16 \div (240 + 16) \times \$100,000 = \$6,250$$
The total depreciation the company can claim in the 20X2-X3 income year is $8,203 ($1,953 + $6,250). For each subsequent income year (until the year in which the right expires) the company will be able to claim depreciation of:
$$12 \div (240 + 16) \times \$100,000 = \$4,687$$

250.410 Computer software
A policy statement on the income tax treatment of computer software is given in the Appendix to TIB vol 4:10 (May 1993). It applies to expenditure incurred from 1 July 1993. Software expenditure incurred before 1 July 1993 was fully deductible as an expense for tax purposes. The following summary applies to software purchases from 1 July 1993,
(a) The cost of purchase is capitalised and depreciated;
(b) An immediate write-off is available for software costing less than $500;
(c) The cost of maintenance may be deducted;
(d) The cost of upgrades must be capitalised and depreciated.
When software is acquired under a finance lease:
(a) The cost price of software is capitalised and depreciated;
(b) The interest component of lease payments may be deducted;
(c) Maintenance costs may be deducted;
(d) The cost of upgrades must be capitalised and depreciated.
When software is developed in-house for use in business:
(a) Pre-development expenses may be deducted;
(b) Development expenses must be capitalised until the project is completed and then depreciated;
(c) The costs of unsuccessful development may be deducted upon application to the CIR under s EE 39;
(d) Maintenance costs may be deducted;
(e) The cost of upgrades must be capitalised and depreciated.
When commissioned software is acquired:
(a) Development costs must be capitalised until the project is accepted, then depreciated;
(b) The costs of unsuccessful development may be deducted upon application to the CIR under s EE 39;
(c) Maintenance costs may be deducted;
(d) The cost of upgrades must be capitalised and depreciated.
250.410(1)  Depreciation

The applicable depreciation rate for the above purposes is 50 per cent DV or 40 per cent SL (for software purchased from 1 April 2005).

When software is leased other than under a finance lease, lease payments are deductible over the term of the lease, subject to the general permission and general limitations [subpart DA].

When software is developed for sale or licence:

(a) Development costs are deductible in the year incurred;

(b) The value of unbilled work in progress and unsold completed software must be taken into account as trading stock. The value of trading stock at balance date must be included as income in the taxpayer’s return.

(1) Treatment of unsuccessful software development

After the issue of the policy statement in the May 1993 TIB, the CIR’s position on the deductibility of the cost of unsuccessful software development has changed. The CIR no longer considers that expenditure on software development where the software is never implemented or used in the taxpayer’s income earning process is deductible. This applies whether the software is developed in-house or commissioned. Consequently, the parts of the May 1993 TIB item that refer to this issue are withdrawn with effect from the start of the 2011–12 income year. The effect of this new policy is to create a category of expenditure that is never deductible: the expenditure on developing the software is not deductible because it is capital in nature [s DA 2(1)] and the resulting property created is not depreciable because it is not implemented or used in the income earning process. See TIB vol 23:4 (May 2011), at 2.

Note: The Minister of Revenue announced on 22 June 2011 that businesses should be able to claim tax deductions on failed software developments because not to do so would inhibit productivity and innovation. Amending legislation was introduced in the Taxation (Annual Rates, Returns Filing, and Remedial Matters) Bill on 14 September 2011. It is proposed that new s DB 40B will apply from the 2008–2009 income year and will override the capital limitation.

Expenditure incurred in developing software may amount to scientific research [s DB 33] or research and development [s DB 34, see 240.200 and 1240.20].

250.420 Disposal of intangible property [ss EE 44(2), EE 47(9)]

Since intangible property is not disposed of in the same way as other property, s EE 47(9) deems a disposal to include any event that has the effect of stopping the rights that make up intangible property from ever being able to be exercised by the owner. Disposals of property are explained further at 250.440–250.500.

Example:

A taxpayer purchases for $1,000 a five-year franchise that consists of the right to use a secret process and the right to use a trademark. The franchiser supplies the materials to use in the process. After three years the franchiser is declared bankrupt and, under the terms of the franchise agreement, no new materials can be purchased. The intangible property is a FLIP and has a self-assessed depreciation rate of 20 per cent. After three years, $600 worth of depreciation loss has been claimed so the adjusted tax value of the rights held by the franchisee is $400. Since the rights can never be used again, they are deemed to be disposed of and the $400 adjusted tax value can be written-off.

However, a disposal is also deemed under s EE 44(2) not to include a disposal of intangible property as part of an arrangement to replace it with property of the same type. This is to prevent taxpayers writing-off the cost of software that is sent back to the seller in return for a heavily discounted price on a later version. In effect, the original software has just been upgraded. The cost of the upgrade can be added to the cost or adjusted tax value (depending on the depreciation method being used) of the original version.

250.430 Write-off of depreciable property no longer used [s EE 39]

The adjusted tax value of depreciable property that is no longer used is deductible as a depreciation loss if the following conditions are met:

(a) The property is no longer used in deriving assessable income or carrying on a business for the purpose of deriving assessable income;
Depreciation

(250.440)

(b) Neither the owner nor an associated person intends to use the property in deriving assessable income or carrying on a business for the purpose of deriving assessable income; and

(c) The costs of disposing of the property would be more than any consideration that could be derived from disposing of it.

A deduction is also available under s EE 39 in respect of a geothermal well that becomes unavailable for use under s EE 6(4) because the geothermal energy proving period (defined in s YA 1) has ended. This applies from the 2006–2007 income year for wells completed or acquired from 1 April 2003 [see 250.540].

The amount of the depreciation loss is the adjusted tax value of the property at the beginning of the income year. The adjusted tax value of the property at the end of the income year in which the deduction is made is zero. If the taxpayer subsequently disposes of any property for which the deduction has been allowed, s EE 48 still applies as required by s EE 46(1)(a) [see 250.440–250.510].

A deduction is not available under s EE 39 if the property was depreciated using the pool method, or if the property is a building, unless the conditions set out below are met.

A deduction is allowed for the loss (ie the adjusted tax value) when a building is irreparably damaged and rendered useless for deriving income if the damage occurs:

(a) In the 2005–2006 or a later income year;

(b) As a result of the extreme climatic conditions that occurred in February 2004 in New Zealand; or

(c) As a result of the storm event that occurred during July 2004 in the Bay of Plenty.

In addition, a deduction is not available under s EE 39 if the damage to the building was caused by the action or failure to act of the owner of the building, or of an agent or associated person of the owner.

**Example 1:**

Joe owns a warehouse that is used in his import/export business. Flash flooding caused significant damage to the warehouse. An independent assessor concludes that Joe’s warehouse cannot be salvaged. In this situation, Joe would be able to claim a deduction for the adjusted tax value of the building.

**Example 2:**

Martin owns a workshop that is used to manufacture wooden furniture. Fire safety regulations require that the workshop be fitted with fire safety devices such as sprinklers, smoke alarms and fire extinguishers. A safety check of the premises revealed that the sprinklers were not in working order. Subsequently, a fire that was started by an electrical fault caused significant damage to the workshop. The insurance assessor concluded that the damage would not have been irreparable if the sprinklers were in working order. In this situation, Martin would not be able to claim a deduction for the loss as he has not taken reasonable care to ensure the workshop is safe. The likelihood of the workshop being irreparably damaged is not unexpected, as his inaction in not getting the sprinklers in working order had contributed to the result.

For further details, see TIB vol 17:7 (September 2005) at 38–39.

250.440 Disposals and similar events [s EE 44]

In the year that an item of depreciable property is disposed of, no depreciation loss arises [s EE 11(1)]. However, under the disposal rules, an adjustment (which may be either a deduction or assessable income) is made to the person’s net income when they dispose of an item of depreciable property.

The disposal rules set out in ss EE 48–EE 52 (as explained below) apply when a person derives consideration from the disposal (or an event treated as a disposal) of an item of depreciable property, if:

(a) The consideration is of a kind described in s EE 45 [250.470]; and

(b) The item is of a kind described in s EE 46 [250.450]; or

(c) The event is of a kind described in s EE 47 [250.460].

**Note:** The disposal rules apply if (a) is satisfied and either (b) or (c) is also satisfied.

However, the disposal rules do not apply when:

(a) Intangible property is disposed of under an arrangement to replace it with an item of the same kind (eg when software is upgraded to a later version);
(b) A patent application is concluded because a patent has been granted; or
(c) A geothermal well becomes unavailable for use because the geothermal energy proving period has ended.

250.450 Depreciable property to which the disposal rules apply [s EE 46]

The disposal rules apply to an item of depreciable property that a person owns, including fixed life intangible property for which a person has been allowed a depreciation deduction under s EE 33 and software to which s CZ 11 applies. Section CZ 11 applies when a person has been allowed a deduction for software acquired before 1 April 1993. The amount derived from the disposal is income.

The disposal rules do not apply to
(a) Items that are depreciated under the pool method;
(b) Petroleum-related depreciable property;
(c) An item of intangible depreciable property that is excluded depreciable property, other than software;
(d) A land improvement that is excluded depreciable property of a kind for which no depreciation deduction was allowed under s 108 of the ITA 1976.

250.460 Events to which the disposal rules apply [s EE 47]

The events that trigger the disposal rules are:
(a) Change of use or location of use: The change of use, or change of location of use, of an item of property, as a result of which a person is denied a deduction for an amount of depreciation loss for the next income year. An example of this would be when a rental property changes to a wholly personal use. The event is treated as occurring on the first day of the next income year, and (from the 2011–2012 income year) includes a change in use of an item for the purposes of the definition of “commercial fit-out” and a change in status of a building related to an item for the purposes of that definition.
(b) Loss or theft: The loss or theft of an item of property, if the item is not recovered in the income year in which the loss or theft occurred.
(c) Irreparable damage: The irreparable damage of an item of property.
(d) Repossession: The seller’s repossession of an item of property that is sold subject to a reservation of title [see 250.620] because the buyer fails to pay the consideration. The event occurs on the date the item is repossessed.
(e) Unused geothermal well brought into use: For a person’s geothermal well that is unavailable for use under s EE 6(4) because the geothermal energy proving period has ended, the start of the person’s:
   (i) Using the well in deriving assessable income or carrying on a business for the purpose of deriving assessable income;
   (ii) Having the well available for use in deriving assessable income or carrying on a business for the purpose of deriving assessable income [see 250.430 and 250.540].
(f) Statutory acquisition: The acquisition of an item of depreciable property by a person acting under a statutory authority.
(g) Cessation of ownership of lessee fixtures or improvements: The cessation of ownership of a fixture or improvement that a lessee is treated as having under s EE 4(2) or that a person is treated as having under s EE 5(3).
(h) Cessation of rights in intangible property: An occurrence that has the effect that the owner of an item of intangible property is no longer able, and will never be able, to exercise the rights that constitute or are a part of the item of property.
(i) Item leaving New Zealand permanently: The permanent removal from New Zealand of an item of property for which a first year depreciation allowance was claimed under s 112 of the ITA 1976.
250.470 Consideration derived for the purposes of the disposal rules

The consideration for the disposal of an item of depreciable property is the amount that the person derives, excluding any GST (if the person is registered for GST), minus the disposal costs incurred in deriving the amount. The consideration may be modified in specific circumstances by s EE 47(3)-(10) (see (a) to (h) below). Disposal costs (excluding GST, if the person is registered) are subtracted from the amount derived to the extent to which they:

(a) Are not allowed as a deduction other than as depreciation; and
(b) Are not already taken into account in the amount derived.

For these purposes, the consideration may be zero or a negative amount.

The meaning of consideration is modified in the following circumstances:

(a) Consideration not market value: If the consideration received is not the market value of the item, the amount that the person derives is the item’s market value (excluding GST if the disposal is a taxable supply), unless:
   (i) The disposal is a transfer under a relationship agreement; or
   (ii) Any of the following paragraphs (b) to (h) apply.

(b) Change of use or location of use: If there is a change in the way an item is used or in the location of the item, and as a result the owner of the item no longer qualifies for a depreciation deduction, the consideration is the item’s market value (excluding GST if the disposal is a taxable supply). This does not apply to a transfer under a relationship agreement.

(c) Loss or theft: If an item of depreciable property is lost or stolen, and not recovered in the same income year, the amount derived is the amount (excluding GST, if applicable) of insurance, indemnity or compensation received.

(d) Unused geothermal well brought into use: If an unused geothermal well is brought back into use, the amount derived is the amount of the deduction for depreciation loss allowed under s EE 39(4) [see 250.430 and 250.540].

(e) Irreparable damage: If an item of depreciable property is irreparably damaged, the amount derived is the amount of insurance, indemnity or compensation received (excluding GST, if applicable).

(f) Repossession: If an item of depreciable property is repossessed by the seller, the amount derived is the item’s cost minus the net amount paid (excluding GST, if applicable). “Net amount paid” means the amount paid for the item by the buyer less any amount refunded by the seller to the buyer.

(g) Other items: When an item is disposed of along with other items, or from an event that involves other items, the amount derived is the item’s market value (excluding GST if applicable). This does not apply to a transfer under a relationship agreement.

(h) Item leaving New Zealand permanently: When an item of property for which a first-year depreciation allowance has been claimed under s 112 of the ITA 1976 is permanently removed from New Zealand, the amount derived is the item’s market value (excluding GST if applicable). This does not apply to a transfer under a relationship agreement.

250.480 Disposal at a price exceeding adjusted tax value [s EE 48(1)-(1C)]

When the conditions in s EE 44 are satisfied [see 250.440], if the consideration is more than the item’s adjusted tax value on the date on which the disposal or the event occurs, the depreciation recovery income is the lesser of:

(a) The amount by which the consideration exceeds the adjusted tax value; and
(b) The amount given by the following formula:

\[ \text{item depreciation loss} + \text{CZ 11 item amount} + \text{DB 64 item amount} \]

where:
Depreciation

“item depreciation loss” is the total amount of depreciation loss that has been allowed as a deduction for the item;

“CZ 11 item amount” is the amount of any deduction allowed for the acquisition of the item if the item is one to which s CZ 11 applies (ie software acquired before 1 April 1993);

“DB 64 item amount” is the amount of the capital contribution for the item if the item is one to which s DB 64 (capital contributions) applies [see 250.210].

The amount of depreciation loss for the purposes of determining depreciation recovery income includes any deduction allowed for software acquired before 1 April 1993. This is because any consideration received on the disposal of software acquired before 1 April 1993 is assessable under s CZ 11.

The approach to determining depreciation recovery income means that any depreciation loss deductions previously allowed to the taxpayer are recoverable as depreciation recovery income, but any gains derived in excess of original cost are not income under these provisions.

Example:

Purchase price of depreciable property $15,000
Depreciation allowed as a deduction since purchase $3,000
Adjusted tax value $12,000
Item sold for $16,000
Total gain on sale $4,000
Depreciation recovered — income $3,000
Capital gain — not income $1,000

250.490 Disposal at a price less than adjusted tax value [s EE 48(2)]

If the consideration is less than the adjusted tax value of any property on the date on which the disposal or event occurs, the person has an amount of depreciation loss. The depreciation loss is the amount by which the consideration is less than the adjusted tax value. This does not apply if the depreciable asset is a building unless the building has been destroyed or rendered useless for the purpose of deriving income as a result of a qualifying event [see 430.105].

Example:

Purchase price of depreciable property $20,000
Depreciation allowed as a deduction since purchase $9,000
Adjusted tax value $11,000
Item sold for $8,000
Depreciation loss on disposal $3,000

250.500 Disposal of property used partly for business [ss DE 2, EE 49, EE 50]

The depreciation loss on depreciable property with both business and non-business uses must be apportioned accordingly. For this purpose, the ITA separates the types of depreciable property that may have non-business use into motor vehicles and other property. Calculating the amount of depreciation loss on property used partly for business is discussed at 250.100.

Separate rules provide for the calculation of the depreciation loss and depreciation recovery income on disposal of property used partly for business. These rules are contained in:

(a) For depreciation loss on disposal: s DE 2 in relation to motor vehicles and s EE 50 for other items; and

(b) For depreciation recovery income on disposal: s EE 49.
(1) Depreciation loss on disposal: motor vehicles and other items

Although the depreciation loss is dealt with in different provisions, the formula is the same in both ss DE 2 and EE 50. The formula is:

\[
\text{disposal depreciation loss} \times \frac{\text{all deductions}}{\text{base value} - \text{adjusted tax value}}
\]

Where:

“Disposal depreciation loss” is the amount determined under s EE 48(2) (ie the depreciation loss on disposal calculated in the same manner as for property wholly used in the business).

“All deductions” is the amounts of depreciation loss for which the person has been allowed a deduction in each of the income years in which the person has owned the property.

“Base value” and “adjusted tax value” have their ordinary meanings [ss EE 55-EE 60, 250.120].

Example 1:

Anne-Maree is a self-employed salesperson and has calculated using the logbook rules that her car is used 85 per cent for business purposes. The base value (cost) of the car is $18,000, and it is owned for the entire income year. The car was purchased secondhand at the start of the previous year, and the applicable depreciation rate is 30 per cent DV. Total depreciation for the year is $5,400 ($18,000 × 30%). Anne-Maree disposes of her vehicle in the following income year for $12,000 at which time the ATV is $12,600 ($18,000–$5,400). No depreciation loss other than a depreciation loss on disposal can be claimed in the year an item is disposed of: ss EE 11(1) and (4). Disposal depreciation loss is $600 ($12,000–$12,600). All deductions is $4,590 calculated as follows:

\[
($18,000 - $12,600) \times 85\
\]

Base value is $18,000 and ATV is $12,600. The depreciation loss on disposal is:

\[
$600 \times $4,590 / $5,400 = $510.
\]

Alternatively, as the business use percentage was 85 per cent, all other things being equal, the depreciation loss on disposal is $600 × 0.85 = $510.

(2) Depreciation loss on disposal: disposal in first year of use

If a motor vehicle is disposed of in the same income year as it is first used for business purposes, and a loss results, the amount of deduction allowed is calculated under the following formula [s DE 2]:

\[
\text{disposal depreciation loss} \times \text{business proportion}
\]

Where:

“Disposal depreciation loss” is the amount calculated under s EE 48(2) (ie the adjusted tax value less the amount of consideration received on sale);

“Business proportion” is the proportion of business use of the motor vehicle for the income year as calculated under ss DE 3-DE 12.

If an item other than a motor vehicle is disposed of in the same income year as it is first used for business purposes, and a loss results, the amount of deduction allowed is calculated under the following formula [s EE 50(8)-(11)]:

\[
\text{disposal depreciation loss} \times \frac{\text{qualifying use days}}{\text{all days}}
\]

Where:

“Disposal depreciation loss” is the amount calculated under s EE 48(2) (ie the adjusted tax value less the amount of consideration received on sale);

“Qualifying use days” is the number of days in the income year on which the item is owned and used, or available for use, for business purposes or in a way that is subject to FBT;
“All days” is the number of days in the income year on which the item is owned and used, or available for use, for any purpose.

A unit of measurement other than days may be used if it achieves a more appropriate apportionment.

(3) **Depreciation recovery income: motor vehicles and other items**

When an item of property is an item to which s EE 46 applies and is dealt with under either subpart DE (Motor vehicle expenses) or s EE 50 (Depreciation: partial income producing use), then s EE 49 applies if the consideration received on disposal is equal to or less than cost.

Essentially s EE 42 will apportion an amount of depreciation recovery income such that only that amount of depreciation recovery income that relates to the business use of an item is assessable income.

The depreciation recovery income is determined by the following formula:

\[
\frac{\text{all deductions} \times \text{amount of depreciation recovery income}}{(\text{base value} - \text{adjusted tax value})}
\]

Where:

“Amount of depreciation recovery income” is the amount described in s EE 48(1).

“All deductions” is the amounts of depreciation loss for which the person has been allowed a deduction.

“Base value” and “adjusted tax value” have their ordinary meanings [ss EE 55-EE 60].

**Example 2:**

Using the example above that applied to determine the amount of depreciation loss on disposal, assume that instead of $12,000 the vehicle sells for $16,000. Applying the above formula, “amount of depreciation recovery income” is $3,400 ($18,000 - $14,600), “all deductions” is $4,590, “base value” is $18,000 and ATV is $12,600. The depreciation recovery income on disposal is:

\[
\frac{4,590 \times (18,000 - 12,600)}{3,400} = \frac{2,890}{85}\%
\]

In other words, the depreciation recovery income on disposal is the business use percentage multiplied by the amount of depreciation recovery income (85% × $3,400 = $2,890).

**250.510 When disposal deemed to be at market value [s EE 45(3)-(5), (10), (11)]**

The rules that determine the amount of consideration derived on the disposal of depreciable property are set out in s EE 45. Consideration is deemed to be market value of the item when:

(a) The person receives consideration that is not the item’s market value. If the disposal is a taxable supply, market value for this purpose means the GST-exclusive amount.

(b) There is a change of use, or change of location of use, of an item of property as a result of which a person is denied a deduction for an amount of depreciation loss for the item for the next income year. This includes a change in use of an item for the purposes of the definition of “commercial fit-out” [250.340] and a change in the status of a building related to an item for the purposes of that definition.

(c) An item of property is disposed of with other items, or an event occurs involving an item that also involves other items. If the disposal or event involves a taxable supply, market value for this purpose means the GST-exclusive amount.

(d) By virtue of its ceasing to be used in New Zealand and being taken out of New Zealand for use elsewhere (but only in the case of property for which a first-year allowance was granted under s 112 (excluding s 112(8)) of the ITA 1976).

In the case of (a) and (c), consideration is not deemed to be at market value if it relates to a transfer under a relationship agreement.
Depreciation

Consideration is not deemed to be at market value if the disposal of property is one to which ss FC 3 and FC 4 apply [see 1420.197].

The sale of a vehicle one year after it was purchased by a taxpayer company at a price well below the book value resulted in the CIR disallowing the deduction for loss on sale. The TRA noted that there were various ways of establishing a satisfactory valuation at a particular point in time (eg by obtaining a letter from a recognised motor vehicle dealer), even some years after the event if necessary: TRA Case R22 (1994) 16 NZTC 6,105.

250.520 Depreciation recovery income when lost or stolen items recovered [s EE 51]

When property to which s EE 47(3) applies (ie property that has been lost or stolen) is recovered in a later income year, and the property is still used or available for use in deriving assessable income or in carrying on a business for that purpose, the following treatment applies:

(a) The person is treated as deriving an amount of depreciation recovery income equal to the amount of the depreciation loss allowed under s EE 48(2) following the original loss or theft. The income is deemed to be derived in either the year of disposal or the year of recovery, at the option of the person; and

(b) The person is treated as acquiring the property, on the date of recovery, for its adjusted tax value at the beginning of the year of loss or theft.

250.530 Depreciation recovery income when compensation received [s EE 52]

When a person receives an insurance payment or an indemnity payment or any other compensation for any item of depreciable property (other than property that is lost, stolen, or irreparably damaged), an amount equal to the amount by which the compensation received exceeds any expenditure incurred by the person (for the event for which the person received the compensation) is deducted from the adjusted tax value of that property.

Example 1:
An item is damaged and repairs cost $18,000. The insurance proceeds are $17,000.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted tax value</td>
<td>$20,000</td>
</tr>
<tr>
<td>Add repairs</td>
<td>$18,000</td>
</tr>
<tr>
<td>Less insurance proceeds</td>
<td>$17,000</td>
</tr>
<tr>
<td>New adjusted tax value</td>
<td>$21,000</td>
</tr>
</tbody>
</table>

When the adjusted tax value becomes negative through the application of this rule, an amount equal to that negative amount is included in the income in that income year.

Example 2:
An item is damaged and repairs cost $3,000. The insurance proceeds are $8,000.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted tax value</td>
<td>$4,000</td>
</tr>
<tr>
<td>Add repairs</td>
<td>$3,000</td>
</tr>
<tr>
<td>Less insurance proceeds</td>
<td>$8,000</td>
</tr>
<tr>
<td>New adjusted tax value</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

Any insurance receipt for property which is irreparably damaged is consideration derived on the occurrence of an event [s EE 45(8) and s EE 47(4)].
250.540 Unused geothermal well brought into use [s EE 53]

One of the events that trigger the disposal rules is when a person who owns a geothermal well, which was previously unused, starts to use that well (or have it available for use) for business purposes [see 250.460]. This applies from the 2006–2007 income year if the well is completed or acquired from 1 April 2003.

If this event occurs, the owner of the well is treated as having acquired the geothermal well on the day the event occurs for the cost of the well (as determined under subpart EE) before the event occurs. This applies from the 2006–2007 income year if the well is completed or acquired from 1 April 2003 [s EE 47(6)].

A “geothermal well” is a bore or well solely for the purpose of investigating or exploiting geothermal energy in New Zealand [s YA 1].

250.550 Settlement of relationship property [s FB 21]

When depreciable property is transferred on a settlement of relationship property, the transfer is treated as a disposal and acquisition for an amount equal to:

(a) The cost of the property, if the transferor acquired it in the year of transfer; or
(b) The adjusted tax value of the property at the start of the year of transfer, in any other case.

The transferee has a depreciation loss for the property from the date of transfer, whether or not the transferor in fact had a depreciation loss, and is treated as having had a depreciation loss equal to all the depreciation that the transferor had in income years before the year of transfer. The transferee cannot claim more depreciation on the property than the transferor would have had if they had kept it.

If the property is a building, the transferee’s depreciation loss is based on the original cost of the building to the transferor. If the property was acquired, erected, installed, altered, extended, improved or attached by the transferor in the year of transfer, the item is treated as if it were acquired, erected, etc, by the transferee in that income year.

If, at the time the transferor acquired or erected the property, the property had not previously been used or, in the case of a building, had not previously been occupied, these conditions are treated as applying at the date of transfer of the property to the transferee. This means that the transferee can continue to use the depreciation rates that apply to new items.

Section FB 21 does not apply to a resident mining operator to whom s FB 20 applies.

250.560 Partnership reconstitution or dissolution [ss HG 4, HG 5, HG 7]

From 1 April 2008, when a partner disposes of their interest in a partnership, no income tax liability arises if the disposal proceeds do not exceed the net tax book value of the partner’s share of the partnership property by more than $50,000 [s HG 5]. In this situation, the disposal payment is treated as excluded income [s CX 62]. A small partnership (one that is not a limited partnership and has five or fewer partners) may opt out of the partnership interest disposal rules [s HG 5(7)].

In addition, an exiting partner is not required to account for tax on any item of tangible depreciable property that cost the partnership $200,000 or less [s HG 7].

If a partnership is finally dissolved, each partner is treated as disposing of their interest in the partnership to a single third party for a payment equal to the market value of the interest [s HG 4].

See 1050 PARTNERSHIPS for further details.

For the rules that applied prior to 1 April 2008, refer to Staples Tax Guide 2011 or an earlier edition.

250.570 Effect of transferring depreciable property between associated persons [s EE 40]

A person who acquires depreciable property from an associated person, either directly or indirectly, cannot claim more depreciation on that property than the associated person would have been able to if they had retained the property. The aim of this rule is to prevent associated persons achieving a step up in the value of their depreciable property for depreciation purposes to market value. Section EE 40 works by restricting
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the cost of the item to that of the associated person, and the depreciation rate to no greater rate, or equivalent SL or DV rate, than that used by the associated person. Nothing in s EE 40 prohibits a step up to an item’s cost, although other considerations may apply.

For property acquired from an associated person prior to 24 September 1997 see s EZ 12. The predecessor to s EE 40 was substantially amended and applied from 24 September 1997, hence the reference to this date in the ITA 2007.

(1) When the transfer rule applies [s EE 40(1)-(6), (10)]

The transfer rule applies when (from 24 September 1997) a person (Person A) acquires, directly or indirectly, an item of property from an associated person to whom any of the following conditions apply (the income year referred to is the income year of the associated person):

(a) The associated person, but for s EE 11(1), would have been allowed a depreciation deduction for the item for the income year in which Person A acquires it;
(b) The associated person was allowed a depreciation deduction for the item for the income year before the income year in which Person A acquired it;
(c) The associated person has been allowed a deduction for the item under s DZ 9 for either the income year in which Person A acquired the property or the previous income year, and would have been allowed a deduction in either income year if they had incurred a cost for the item for which they were denied any other deduction. Section DZ 9 allows a deduction for a premium paid in respect of a lease of land where the grant or renewal of the lease took place before 1 April 1993;
(d) The associated person would have been allowed a deduction for a depreciation loss for the item:
   (i) For the income year in which Person A acquired it, if they had incurred a cost for the item for which they were denied any other deduction and if s EE 11(1) had not applied; or
   (ii) For the income year before that in which Person A acquired it, if they had incurred a cost for the item for which they were denied any other deduction;
(e) The associated person would have been a person to whom any of paragraphs (a) to (d) applied, if the associated person had not elected under s EE 8 to treat the property as not depreciable.

Generally, the restrictions in s EE 40 will apply if:

(a) An associated person vendor would have been entitled to a deduction for a depreciation loss either in the year of sale or the previous year, but for the restriction in s EE 11(1) (which prohibits a depreciation loss in the year of disposal), for an item of depreciable property or a cost incurred in relation to the property; or
(b) If the associated vendor was entitled to a deduction for a premium paid on the grant or renewal of a lease that occurred before 1 April 1993, or a cost incurred in relation to that lease in either the year of sale or the previous year.

(2) Restriction of the cost [s EE 40(7)]

When the circumstances set out in s EE 40(2)-(6) apply, as summarised above, the cost of the depreciable property to Person A is the lesser of the cost of the item to Person A and the cost of the item to the associated person.

However, if the depreciable property is an item that has, since it was first acquired, been used for a purpose other than deriving assessable income or carrying on a business for that purpose, such that the rule in s EE 58 for determining the item’s base value applies, then the cost of the item is restricted to the lesser of:

(a) The cost of the item to Person A; and
(b) The item’s market value when the associated person starts to use it, or have it available for use, for the purpose of deriving assessable income or carrying on a business for the purpose of deriving assessable income.
(3) **Exclusions [s EE 40(8), (11)]**

The cost restriction rule in s EE 40(7) does not apply to property (excluding depreciable intangible property) that the CIR decides should appropriately be depreciated from the cost of the item to Person A, despite the fact that the transaction is one between associated persons. The way in which the CIR will exercise this discretion is explained in 250.580.

The cost restriction rule also does not apply if the cost to Person A is income of the associated person other than as depreciation recovery income, or if Person A acquires the item under a relationship agreement to which s FB 21 applies. Section FB 21 contains rules restricting the depreciation loss a transferee in a relationship property settlement can claim to that of the transferor in any event.

Section EE 41 (which applies to depreciable property in a non-qualifying amalgamation) [see 250.590] overrides s EE 40. Section EE 40 does not apply to a bequest of property if it is property to which subpart FC applies [see 1420.197] and the property is disposed of at market value.

(4) **Limit on annual rate [s EE 40(9)]**

When the circumstances set out in s EE 40(2)-(6) apply, the annual rate that Person A applies to the property (excluding fixed life intangible property whose rate is set under s EE 33) cannot be more than the rate used by the associated person from whom the property was acquired. If Person A does not use the same depreciation method as the associated person vendor, the annual rate Person A applies to the item cannot exceed the equivalent rate for the other method as given in sch 10.

The specific exclusions that apply to the restrictions on cost do not apply to the limit on the rate. For example, even if the CIR allowed a step up in value for the depreciable property to market value under s EE 40(7)(a), the taxpayer is still restricted to the associated person’s annual depreciation rate in respect of that property.

**250.580 CIR’s discretion on transfer of depreciable property between associated persons [s EE 40(8)(a)]**

When depreciable property is acquired by a taxpayer from an associated person, the cost of the property for depreciation purposes is normally limited to its cost to the associated person [see 250.570]. However, the CIR has the discretion to allow a taxpayer to calculate depreciation based on the cost of the property to the taxpayer, rather than on the original cost to the associated person. When deciding whether to exercise this discretion, the CIR will consider the following factors:

(a) Whether the transfer is genuine;
(b) Whether the transfer is made at no more than the fair market value;
(c) Whether legal ownership of the property is permanently transferred;
(d) Whether the associated vendor (or its controllers) retains virtual ownership of, or beneficial interest in, the transferred property:
   (i) Through power over or control of the associated purchaser; or
   (ii) Through a leaseback or similar arrangement; or
   (iii) Through continued use of the transferred property for income-producing purposes; and
(e) The commercial or non tax-related reasons for the transfer of the property.

Depreciation should not be claimed on the transfer price basis until the CIR has confirmed that this basis may be used.

Taxpayers wanting approval to base their depreciation on the cost of property acquired from an associated person should apply to Inland Revenue in writing with supporting documentation. Alternatively, application can be made for a private binding ruling. The supporting documentation should include all relevant transaction documents, correspondence, and a summary of any unwritten terms of understanding between the parties. These documents may include:

(a) Certificates of title;
Depreciation

(b) Sale and purchase agreements;
(c) Financial, gifting, and legal documents relating to the transaction;
(d) Independent valuation reports;
(e) Acknowledgements of debt;
(f) Loan agreements; or
(g) Constitutional documents (eg trust deeds).

The CIR will need to be satisfied that the transfer was undertaken for business or commercial reasons, and not just to achieve a tax advantage. Care should be taken to ensure that the application is complete. The CIR has indicated that Inland Revenue will not waste resources on applications that are incomplete or ambiguous.

Example 1:
Mr and Mrs H bought a house in Wellington 10 years ago for $260,000 and have been living in it ever since. Mr H has recently been promoted in his employment and Mr and Mrs H have relocated to Auckland. They have decided to rent out their house in Wellington to an unrelated third party. They have obtained an independent valuation from a registered valuer, who advises that the property has a market value of $650,000. Instead of carrying on the rental activity themselves, they set up a look-through company (LTC) and sell the house to the LTC. Mr and Mrs H and the H Family Trust are equal shareholders of the LTC. H Family trust has been settled with Mr H as one of the trustees, and the beneficiaries are Mr and Mrs H’s children. The legal title of the property in Wellington is transferred to the LTC. The LTC is responsible for paying the interest on the mortgage, rates, insurance and any repairs. The unrelated tenant pays their weekly rent by direct credit to the LTC’s bank account. The LTC seeks to depreciate the property based on its acquisition cost of $650,000, which is also the market value of the house. A request has been made under s EE 40(8)(a). The CIR would not exercise the discretion under s EE 40(8)(a) in this example, even though the transfer of the depreciable property is genuine and permanent and the transfer price does not exceed the fair market value. The reasons are as follows:

(a) Mr and Mrs H continue to benefit indirectly from the transferred property. Mr and Mrs H have a legal and equitable interest in the LTC. If the LTC makes a profit or a loss from the rental activity, Mr and Mrs H, in their capacity as shareholders of the LTC, will receive a distribution of the profit or an allocation of the loss.
(b) The non tax-related reasons for the transfer of the real property do not outweigh the factor that the transferors retain significant beneficial interests in the transferred property. Mr H’s promotion in his employment and family relocation seem to be the only non tax-related reasons for the transfer in this example. The CIR considers that these reasons are not sufficient to displace the transferors’ significant beneficial interest in the transferred property.

[Note: In the original Inland Revenue example, the LTC was an LAQC.]

Example 2:
Jack, a 70-year-old sole trader operating a dairy decides to sell the business assets to his nephew, Johnny. Johnny will take over Jack’s dairy business. Jack and Johnny enter into a sale and purchase agreement, whereby all the business assets in the dairy will be sold to Johnny at a price based on an independent valuation. The payment consists of an Acknowledgment of Debt for 75 per cent of the transferred price and cash for the remaining 25 per cent. Jack retires after the transfer. Johnny carries on the dairy business. Jack helps out in the dairy occasionally but is not otherwise involved in the business. Jack forgives some of the debt annually. Johnny requests that the CIR exercises the discretion under s EE 40(8)(a). Jack and Johnny are associated persons in accordance with the definition of “relative” in s YA 1. The CIR will exercise the discretion under s EE 40(8)(a) to allow Johnny to claim tax depreciation on the basis of the assets’ transferred price. This is because:

(a) The transaction is genuine. The transfer of the assets is the result of genuine negotiation between Jack and Johnny. Consideration has passed by Johnny to Jack for the transfer of business assets.
(b) The transferred price is at a fair market value. The transferred price does not exceed the fair market value of the business assets.
(c) The transfer of business assets is permanent. The parties to the transaction do not intend to lease or transfer the business assets of the dairy back to Jack.
(d) The transferor does not continue to benefit from the transferred property. Jack does not have any control over the transferred assets in the dairy. Johnny runs the dairy business by himself. Jack only helps out occasionally.
(e) The transfer is not tax driven. The main reasons for the transaction are to enable Jack to retire due to his old age and for succession planning.

However, Jack is required to calculate depreciation recovery income on disposal at the time of the transfer. For further details see standard practice statement SPS 07/05 [see TIB vol 19:9 (October 2007) at 16].
250.590 Transfer of depreciable property in non-qualifying amalgamation [s EE 41]

Under the amalgamation rules in subpart FO, the general position taken in the case of a non-qualifying amalgamation [s FO 11] is that the property is deemed to be disposed of by the amalgamating company, and acquired by the amalgamated company, for its market value.

By using a non-qualifying amalgamation, taxpayers could avoid the rules for transfers of assets between associated persons and achieve a step up in the depreciation base of their depreciable property to market value. This is not possible for items acquired in these circumstances from 14 May 2002, when the rules in s EE 41 were first introduced.

The rules in s EE 41 largely mirror those applying for the purposes of s EE 40, in placing restrictions on both the cost of the item transferred, and on the depreciation rate able to be used.

1) When the transfer rules apply [s EE 41(1)]

The rules in s EE 41 apply when, from 14 May 2002, an amalgamated company acquires, directly or indirectly, an item of property from an amalgamating company and:

(a) The acquisition of the item is part of a non-qualifying amalgamation; and

(b) The amalgamating company is an associated person of the amalgamated company, treating the amalgamating company as existing at the time that the amalgamated company is treated under ss FO 11(1)(b) or FO 15(3) as having acquired the property from the amalgamating company.

2) Restrictions on the cost [s EE 41(2)]

If the transfer rules apply, the cost of the item of depreciable property is the lesser of the cost of the item to the amalgamating company and the value given under the amalgamation rules in ss FO 11 or FO 15 (ie the item’s market value).

However, if the depreciable property is an item that has, since it was first acquired, been used for a purpose other than deriving assessable income or carrying on a business for that purpose, such that the rule in s EE 58 for determining the item’s base value applies, then the cost of the item is restricted to the lesser of:

(a) The value given under ss FO 11 or FO 15; and

(b) The item’s market value when the amalgamating company starts to use it, or to have it available for use, for the purpose of deriving assessable income or carrying on a business for the purpose of deriving assessable income.

3) Exclusions [s EE 41(3)]

The cost restriction rule in s EE 41(2) does not apply to property (excluding depreciable intangible property) that the CIR decides should appropriately be depreciated from the cost of the item to the amalgamated company, despite the fact that the transaction is one between associated persons. The cost restriction rule also does not apply if the cost to the amalgamated company is income of the amalgamating company, other than as depreciation recovery income.

4) Limit on rate [s EE 41(4), (5)]

The restrictions on the annual depreciation rate [see 250.580] also apply in the case of non-qualifying amalgamations, except in the case of fixed life intangible property whose rate is set under s EE 33. Section EE 40(4) provides that the annual depreciation rate used by the amalgamated company cannot exceed that of the amalgamating company, or the equivalent rate under sch 10 if a different depreciation method is used.

250.600 Transfer of depreciable property between 100 per cent commonly-owned companies

When depreciable property is transferred between 100 per cent commonly owned companies, the vendor company should calculate depreciation recovery income or depreciation loss on disposal on the actual sale.
price. If the property has been disposed of for a consideration that is not market value, s EE 45(3) will treat the consideration as the market value of the property. In these circumstances the vendor must calculate depreciation recovery income or a depreciation loss on disposal on the amount of consideration applying for the purposes of s EE 45. The purchasing company should value the property at the cost it incurred, or the value required under s EE 40.

The amount of depreciation the purchasing company may claim is limited by s EE 34 [see 250.390].

250.610 Petroleum-related depreciable property [s EE 17, EE 59]

“Petroleum-related depreciable property” is petroleum drilling rigs, support vessels for offshore petroleum drilling rigs, and support vessels for offshore petroleum production platforms [s EE 67]. Because of the special nature of this property, the depreciation calculation is done on a daily rather than a monthly basis [s EE 17].

Furthermore, under s EE 59, the term “base value” for petroleum-related depreciable property acquired by the taxpayer from an associate person is the lower of the cost of the property to the taxpayer and the aggregate of:

(a) The cost of the property to:
   (i) The associated person who did not acquire the property from either the taxpayer or another associated person; or
   (ii) The taxpayer or an associated person who owned the property at the start of an unbroken chain of ownership made up of the taxpayer one or more associated persons; and

(b) All expenditure incurred for the property by the taxpayer and any associated person before the date of acquisition of the property by the taxpayer.

The terms “cost and expenditure” are defined in s EE 59(5) as exclusive of any expenditure allowed as a deduction under s EE 38(2) (low-value item deductions), s EE 48(2) (depreciation loss on disposal), and expenditure that is or would be allowed as a deduction under any other subpart of the ITA 2007 or corresponding provisions of the ITA 2004 or ITA 1994.

No adjustment is made on disposition or exit from the tax base under s EE 46(2) for petroleum-related depreciable property.

250.620 Goods subject to reservation of title (“Romalpa” clause) [s EE 3]

A purchaser of depreciable property is entitled to claim a deduction for depreciation on the property before title to the property passes, if:

(a) A person (the purchaser) enters into an unconditional contract to buy an item of depreciable property;
(b) The item is not subject to a hire purchase agreement;
(c) The contract is subject to the Sale of Goods Act 1908;
(d) Title to the property does not pass until the purchase price is paid in full; and
(e) The purchaser takes possession of the property before title passes.

When these conditions are met, the purchaser is treated as owning the depreciable property and is able to claim depreciation from the later of:

(a) The time the purchaser enters into the contract; or
(b) The time the purchaser takes possession of the property.

At the same time, the seller (the vendor) is treated as not owning the item and is prevented from claiming depreciation. The period of deemed ownership expires when actual title passes to the purchaser or if the seller repossesses the item.

If the vendor repossesses the property, an event that triggers the disposal rules is deemed to have occurred on the date on which the item is repossessed [s EE 47(5)]. The consideration that a person derives from the repossession is the item’s cost minus the net amount paid by the buyer [s EE 45(9)]. “Net amount paid” is
defined as the amount paid by the purchaser less any amount refunded by the vendor. If the person from whom the item was repossessed is GST registered, the consideration does not include any GST charged on the taxable supply.

Example:
If the purchase price of an item is $10,000, the purchaser has paid $5,000 towards the property, the vendor repossesses the item and refunds $3,000 to the purchaser, the purchaser is deemed to dispose of the item for $8,000 ($10,000 − $5,000 + $3,000).

Intangible property which may be depreciated is described in sch 14 as depreciable intangible property [see 250.360].

Depreciable intangible property which is fixed life intangible property may be depreciated using the SL method.

250.630 Application of old depreciation rates [ss EE 30, EE 32, EZ 23]

(1) Depreciation rate for property with high residual value [s EE 30]
The “old” economic depreciation rates apply to plant and equipment acquired from 1 April 2005 and buildings acquired from 19 May 2005 if they have an estimated residual market value that is greater than 13.5 per cent of their cost. This does not apply to fixed life intangible property or excluded depreciable property.

The method for setting the rate is identical to that used in s EZ 23 (see below).

(2) Election to continue using old depreciation rates [s EE 32]
Depreciable property (other than buildings) acquired from 1 April 2005 and the end of the taxpayer’s 2005–2006 tax year may be depreciated for the 2005–2006 and subsequent tax years using the economic depreciation rates determined under s EZ 23 (ie the “old” economic depreciation rates). The election to use the old depreciation rates must be made in the taxpayer’s return of income for the 2005–2006 tax year.

(3) Depreciation rates for plant or equipment acquired before 1 April 2005 [s EZ 23]
The “old” economic depreciation rates continue to apply to the following categories of assets:
(a) Depreciable property, other than buildings, fixed life intangible property and excluded depreciable property, acquired before 1 April 2005;
(b) Buildings acquired before 19 May 2005; and
(c) Buildings acquired from 19 May 2005, as relationship property or from a company in the same wholly-owned group of companies, from a person who depreciated the building using the “old” economic depreciation rate.

The “old” economic depreciation rates were set by the CIR using the procedure explained in Staples Tax Guide (2006), 250.60. The old economic depreciation rates are set out in 6000.20 and 6000.30 (Online and CD only).

250.640 Property acquired before the end of 1994–1995 income year
[ss EZ 13, EZ 14]
Sections EZ 13 and EZ 14 give taxpayers a choice of two depreciation rates for depreciable property (other than excluded depreciable property) acquired before the end of the 1994–1995 income year. The depreciation rate can be either the economic depreciation rate or the asset’s pre-1993 depreciation rate.

Note: From the 2011–2012 income year, no depreciation can be claimed on buildings with an estimated useful life of 50 years or more, no matter when they were acquired.

The pre-1993 depreciation rate for an asset is the depreciation rate the CIR allowed to be used for that class of property in the 1992–1993 income year. The pre-1993 depreciation rate always included any supplementary depreciation allowance that would have been allowed under s EZ 16 [see 250.680], and the 25 per cent interim loading if it would have been allowed by the ITA 1976, s 108A as it applied in the 1992–1993 income year.

An election to use the pre-1993 depreciation rate may be made for all or any items of property, and is done by applying the pre-1993 depreciation rate to those items in the return of income for the income year for
Depreciation

which the election is made. This choice can continue as long as the taxpayer holds the property. Once the
election is made it may not subsequently be altered for the income year for which it was made.

The term pre-1993 “depreciation rate”, for any item of depreciable property, means the rate of depreciation
that the CIR allowed to be used in the 1992–1993 income year as a depreciation allowance (as then in force)
for depreciable property of that class. This is defined in s EZ 14(5) as:

\[
\text{section 108 rate + section 108A rate + section 113A rate}
\]

These terms are all defined in s EZ 14. In short, the “section 108 rate” is the pre-1993 depreciation rate, the
“section 108A rate” means the 25 per cent interim loading available to certain property, and the
“section 113A rate” was the supplementary shift allowance rate.

Note: Section 108A of the ITA 1976 was renumbered as s 108N of the ITA 1976 from 1 April 1993 which
is the reason the legislation refers to s 108A as in force for the 1992–1993 tax year.

If the pre-1993 depreciation rate is a DV rate, a taxpayer who has elected to use the pre-1993 rate may instead
depreciate the depreciable property at the SL rate determined by rounding (if necessary) that DV rate to the
nearest rate specified in the column 1 of sch 10, and ascertaining the equivalent SL rate (if any) specified in
the column 2 of sch 10. The provisions work in reverse for a taxpayer using an SL rate and wishing to change
to the equivalent DV rate.

The precise rate used for some assets does not appear in sch 10. When this occurs, round the actual rate to
the nearest rate in the relevant column. The appropriate equivalent is the rate directly opposite.

Example:
The pre-1993 rate for water-fed evaporating type air conditioners was 15 per cent DV. If acquired between 16 December 1991
and 31 March 1993 (or acquired by the taxpayer from 1 April 1993, and before 1 April 1994, under a binding contract entered
into by the taxpayer during the period 16 December 1991 and 31 March 1993) it was also eligible for the interim loading of
25 per cent bringing the DV rate to 18.8 per cent. To find the alternative SL depreciation rate find the nearest rate to 18.8 per
cent in the DV rate column of sch 10 – which is 19 per cent. The equivalent SL rate is 13 per cent.

250.650 Additional depreciation for certain new assets from 16 December 1991 [ss EZ 17, EZ 18, EZ 19, EZ 26]

Certain assets and improvements (referred to as “qualifying assets” and “qualifying improvements” — see
definitions below) acquired or made between 16 December 1991 and 31 March 1993 qualify for an additional
depreciation loss of 25 per cent of the depreciation loss, which includes the supplementary depreciation loss
for machinery used in two and three shift industries [s EZ 16], that would have otherwise been allowed in
the absence of this provision.

This applies to capital expenditure incurred in the acquisition or installation of a qualifying asset or in the
making of a qualifying improvement to any asset owned by the taxpayer. The additional depreciation loss is
subject to s EE 48(2).

The additional depreciation loss allowed is 25 per cent of the lesser of the amount of the depreciation under
subpart EE and s EZ 16, or the depreciation deduction that would have been allowed had the asset’s value
been equal to its qualifying capital value. “Qualifying capital value” is defined in s EZ 26 and is discussed
below.

The following definitions are relevant to the definition of “qualifying capital value” in that that definition
uses the definition of “qualifying asset” and “qualifying improvement”.

“Qualifying asset” is defined in s EZ 26 and means:

(a) Any “new asset” (other than a building), that is owned by the taxpayer in that income year; and

(b) Any “New Zealand-new asset” (other than a motorcar or a building), that is owned by the taxpayer
in that income year,

in respect of which the taxpayer is allowed a depreciation deduction for that income year.

“New asset” is defined in s EZ 24 and means any asset that is either:
(a) Acquired during the period commencing on 16 December 1991 and ending on 31 March 1993 (both dates inclusive) otherwise than under a binding contract entered into before 16 December 1991;

(b) Acquired from 1 April 1993, and before 1 April 1994, under a binding contract entered into during the period commencing on 16 December 1991 and ending on 31 March 1993 (both dates inclusive); or

(c) Acquired by the taxpayer before 16 December 1991 as trading stock, but from 16 December 1991 and before 31 March 1993 first used as a capital asset and qualifying for a depreciation allowance.

Furthermore, the asset must be used, by the taxpayer, before 1 April 1994; and has neither:

(a) Been used, acquired, or held by any person before the date on which the taxpayer acquired the asset, for use before that date; nor

(b) For any period occurring before the date of its acquisition by the taxpayer, been an asset for which any deduction by way of depreciation has been allowed or allowable.

In the case of an asset requiring construction, it does not include any such asset where construction of the asset commenced before 16 December 1991 (except when the asset is trading stock that was later used as a capital asset) or construction commenced after that date under a binding contract entered into by the taxpayer before that date; or construction of the asset was not completed, or the asset was not first used by the taxpayer before 1 April 1994.

“New Zealand-new asset” is defined in s EZ 25. The definition excludes any “new asset”, otherwise it has a similar definition to a “new asset” but with the further qualification that it has not been used in New Zealand by the taxpayer before the date on which the taxpayer acquired the asset.

“Qualifying improvement” is defined in s EZ 27 as any capital improvement of the asset (but not an improvement to a building) where the expenditure for the improvement was incurred by the taxpayer during the period commencing on 16 December 1991 and ending on 31 March 1993 (both dates inclusive) otherwise than under a binding contract entered into before 16 December 1991; or incurred from 1 April 1993, and before 1 April 1994 under a binding contract entered into during the period commencing on 16 December 1991 and ending on 31 March 1993.

Further qualifications are that the asset must be used in its improved form, by the taxpayer, before 1 April 1994 and person is allowed a depreciation deduction for the improvement. Where the improvement arises from construction, it does not include any such improvement when construction of the improvement commenced before 16 December 1991, or commenced after that date under a binding contract entered into by the taxpayer before that date; or construction of the improvement is not completed, or the improvement is not first used by the taxpayer before 1 April 1994.

“Qualifying capital value”, is defined in s EZ 26 and builds on the above definitions. For any qualifying asset owned by a taxpayer, “qualifying capital value” means:

\[(\text{acquisition cost} + \text{improvement cost}) - \text{item’s depreciation}\]

Where:

“Acquisition cost” is the capital expenditure incurred in acquiring the asset, less in the case of any asset requiring construction, the amount of any such expenditure incurred from 1 April 1993 otherwise than under a binding contract entered into before that date.

“Improvement cost” is the amount of capital expenditure (if any) the person incurs in making a qualifying improvement to the asset.

“Item’s depreciation” is the amount of any depreciation loss allowed for the qualifying capital value (as determined under this paragraph) of the asset in any previous income year, other than any such depreciation loss determined on an SL basis.

The qualifying capital value for any asset owned by a taxpayer that is not a qualifying asset but to which the taxpayer has made a qualifying improvement, is:

\[\text{capital expenditure} - \text{improvement’s depreciation}\]

Where:
“Capital expenditure” is the amount of capital expenditure incurred by the taxpayer for that improvement. “Improvement’s depreciation” is the amount of depreciation loss allowed to the taxpayer for the qualifying capital value (as determined under this paragraph) of the improvement in any previous income year, other than any such depreciation loss determined on an SL basis.

Under s EZ 18, when a qualifying asset, or an asset to which a qualifying improvement has been made, is at any time before 1 April 1993 sold or otherwise disposed of by one company in a wholly-owned group of companies [as defined in s IC 4], to another company in the same wholly-owned group, then:

(a) The transferee company has an amount of depreciation loss under s EZ 17 for the period after disposal as if the transferee company were the transferor company, but
(b) The amount of depreciation loss that the transferor company has under s EZ 17 for the asset for the income year in which the disposal occurs must be subtracted when the amount of depreciation loss that the transferee company has under s EZ 17 for the income year is calculated.

Similar rules apply when a qualifying asset or qualifying improvement is transferred in accordance with a relationship agreement [s FB 21].

When a person who has derived nothing but exempt income starts to derive assessable income and would have had an amount of depreciation loss under s EZ 17 if the income was assessable at the time the asset was acquired that item’s qualifying capital value is determined as if the person had had an amount of depreciation loss for the period during which they derived nothing but exempt income [s EZ 19].

250.660 Excluded depreciable property [ss EE 64, EZ 15]

“Excluded depreciable property” is defined in s EE 64 and means any depreciable property:

(a) For whose purchase or construction a binding contract the person entered into a binding contract before 16 December 1991;
(b) That the person used or had available to be used for any purpose whatever within New Zealand, other than as trading stock, before 1 April 1993;
(c) That is an intangible asset that was used or was available for use by the taxpayer before 1 April 1993;
(d) That is or has been for the taxpayer a qualifying asset within the meaning of s EE 16; or
(e) To the extent that the property is or has been for the taxpayer a qualifying improvement within the meaning of s EE 16.

However, it does not include any item of property in existence at the end of the 1992–1993 income year that was permitted by the CIR to be accounted for in that income year using any of the standard value, replacement value, or annual revaluation methods.

From the 2011–2012 income year, buildings of the type that attract a zero per cent rate of depreciation (known as “special excluded depreciable property”) are excluded from the term “excluded depreciable property” [see 250.670].

The annual depreciation rate for any excluded depreciable property is referred to in s EZ 15 as the “section 108 rate”. This is the rate of depreciation that the CIR allowed as a depreciation allowance for depreciable property of that class in the 1992–1993 income year for a standard balance date taxpayer under s 108 of the ITA 1976, as in force for the 1992–1993 tax year.

The “section 108 rate” specifically excludes the “section 108A rate” and the “other sections rate”. The “section 108A rate” means the rate of additional depreciation deduction under s 108A of the ITA 1976 as it applied for the 1992–1993 tax year, and for which an item was eligible for that rate. Essentially this was the uplift in the depreciation rate of 25 per cent when this was applicable [s EZ 16].

The “other sections rate” means a rate of additional or supplementary deduction under s 113A of the ITA 1976 or any other provision of the ITA 1976 for which the item was eligible for the 1992–1993 tax year [s EZ 17].
However, if a person has an additional amount of depreciation loss for an income year for an item of excluded depreciable property under ss EZ 16 or EZ 17, or any other provision, then the rate for the excluded depreciable property may be adjusted to incorporate that additional amount of depreciation loss in such manner as may be prescribed or allowed by the CIR. When this is the case the person does not have a separate amount of depreciation loss under ss EZ 16 and EZ 17 or the other provision.

When the depreciation rate is a DV rate, the depreciable property may instead be depreciated at the SL rate determined by rounding (if necessary) that DV rate to the nearest rate specified in the column 1 of sch 10, and ascertaining the equivalent SL rate (if any) specified in column 2 of sch 10. When the depreciation rate is an SL rate, the person may change to the DV rate by rounding (if necessary) that SL rate to the nearest rate specified in column 2 of sch 10 and taking the equivalent DV rate from column 1.

250.670 Special excluded depreciable property [s EE 61(7B), EE 64(3), EE 67, sch 39]

The annual rate of depreciation that applies to special excluded depreciable property that would be excluded depreciable property but for the exclusion in s EE 64(3) is zero per cent for all depreciation methods. This applies from the 2011–2012 income year.

Excluded depreciable property does not (from the 2011–2012 income year) include special excluded depreciable property [s EE 64(3)].

The formal definition is given below, but in essence, special excluded depreciable property means buildings that were excluded depreciable property (that is, buildings depreciated at the rates that applied before the economic rates were introduced from 1 April 1993: see 250.660 for details) and which are similar to the current categories of building that have estimated useful lives of 50 years or more. The distinction is necessary because the zero per cent rate of depreciation is intended to apply to all buildings which are expected to last for 50 years or more. Items of excluded depreciable property do not have estimated useful lives so it is necessary to refer to them in a different way. The annual rate applying to such buildings from the 2011–2012 income year is zero per cent.

“Special excluded depreciable property” is defined as all buildings not listed in sch 39 [s EE 67]. The buildings listed in sch 39 are:

- Buildings affected by acid
- Carports (hired out to householders)
- Cool-stores and freezing chambers
- Fowl houses
- Glasshouses
- Milking sheds
- Milk powder buildings
- Plastic hothouses
- Portable huts
- PVC tunnel houses
- Roofed livestock yards
- Slaughterhouses on farms
- Temporary buildings
- Wintering barns and simple loafing barns

Example:
A wooden-framed building acquired in 1989 as a business premises and still in use is depreciated at the pre-1 April 1993 rate of 2.5 per cent DV or two per cent SL (see the Inland Revenue booklet Historic depreciation rates, IR 267) until the end of the 2010–2011 income year. From the 2011–2012 income year this building would be classified as an item of special excluded depreciable property (because it is a building not listed in sch 39) and no depreciation deduction can be claimed on it.
Depreciation

250.680   **Additional depreciation for machinery used in shift industries**  
[s EZ 16]

A person is allowed an additional amount of depreciation loss when calculating their net income where:
(a) They are engaged in any business in New Zealand;
(b) They have incurred expenditure of a capital nature in acquiring, installing, or extending any two-shift or three-shift plant and machinery before the 1993–1994 income year; and
(c) The two-shift or three-shift plant and machinery is used wholly for the purposes of any business carried on in New Zealand.

The additional depreciation loss does not apply to depreciable property acquired from the 1993–1994 income year, unless that property is excluded depreciable property [see 250.660].

The provisions do not apply to:
(a) Plant and machinery used in refining petroleum or smelting aluminium;
(b) Motor cars;
(c) Plant or machinery for which a deduction by way of a fixed rate was not, for the 1992–1993 income year or any earlier relevant year, allowed under s 108 of the ITA 1976 [ITA 2007, s EE 11]; and
(d) Plant and machinery for which the CIR has not, in determining a rate of depreciation, prescribed a differential rate for more than one shift operation for the 1992–1993 income or earlier relevant year.

1) **Three-shift plant and machinery**

This means any plant and machinery that is normally in operation for 24 hours each working day. The additional depreciation loss is equal to six per cent DV.

2) **Two-shift plant and machinery**

In relation to the business of the taxpayer and any income year, this means any plant and machinery, not being three shift plant and machinery, that is normally in operation for an average of not less than 16 hours each working day. The additional depreciation loss is equal to three per cent DV.

The additional depreciation loss is allowed in the first, second, third, fourth, and fifth income years in which the plant and machinery is used in the derivation of assessable income, and is in addition to the depreciation allowance under s EZ 15.
Chapter 260
Disputes and Challenges Procedures

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260.05 Purpose of disputes procedures rules [TAA, s 89A]

The disputes procedures came into force on 1 October 1996. The purposes of the procedures are to:

(a) Improve the accuracy of disputable decisions made by the CIR under the Inland Revenue Acts;
(b) Reduce the likelihood of disputes arising between the CIR and taxpayers by encouraging open and full communication in both directions;
(c) Promote the early identification of the basis for any dispute concerning a disputable decision; and
(d) Promote the prompt and efficient resolution of any dispute concerning a disputable decision by requiring the issues and evidence to be considered by the CIR and a disputant before the disputant commences proceedings.

The disputes procedures do not apply to any tax returns or notices of assessment that are subject to the objection proceedings under Part 8 of the TAA.

In certain circumstances, taxpayers can correct small errors in income tax, FBT and GST returns without the need to follow the formal disputes procedures. For example, requests for the correction of errors such as the transposition of numbers or arithmetical mistakes can be made by telephone or in writing [see 580.113 and 1270.75].

260.10 Definitions [TAA, ss 3, 89AB]

The following definitions apply for the purposes of the disputes procedures regime.

“Assessment” means:
(a) An assessment of tax made under a tax law by a taxpayer or the CIR;
(b) An assessment of a net loss;
(c) An assessment of terminal tax or a refund of income tax;
(d) An assessment of a GST refund due; or
(e) An amendment of an assessment by the CIR.

“Challenge” means:
(a) To commence proceedings under Part 8A of the TAA challenging a disputable decision;
(b) To commence proceedings under s 89K(6) challenging a refusal to issue a notice; or
(c) The proceedings themselves depending on the context.

“Challenge notice” means a notice issued by the CIR in accordance with s 89P (taxpayer-initiated disputes).

“Decision” (in the expression “disputable decision”) includes the making, giving, or exercising of a discretion, judgment, direction, opinion, approval, consent, or determination by the CIR.

“Disputable decision” means either an assessment or a decision of the CIR under a tax law. The following decisions by the CIR are not disputable decisions:
(a) A decision not to issue a binding ruling under Part 5A;
(b) A decision that cannot be the subject of an objection under Part 8;
(c) A decision that cannot be challenged under Part 8A; or
(d) A decision to issue a CIR’s NOPA under s 89B, a CIR’s disclosure notice or statement of position under s 89M, or a challenge notice.

“Disputant” means a person who may issue a notice of proposed adjustment (NOPA) to the CIR, a person to whom the CIR issues an assessment or a NOPA, or a person who may challenge a disputable decision.
“Notice of proposed adjustment” (NOPA) means a notice (in the prescribed form), issued by the CIR under s 89B of the TAA, or issued by a disputant to the CIR under ss 89D or 89DA of the TAA.

“Response period” for a notice in response to an initiating notice means:

<table>
<thead>
<tr>
<th>Type of initiating notice</th>
<th>Response period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notice of proposed adjustment</td>
<td>Two months starting on the date of the issue of the notice.</td>
</tr>
<tr>
<td>Notice of assessment issued by a taxpayer</td>
<td>For a NOPA:</td>
</tr>
<tr>
<td></td>
<td>(a) Four months starting on the date of issue of the initiating notice; or</td>
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<td></td>
<td>(b) If the NOPA relates solely to the amount of a tax credit for expenditure on</td>
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<td></td>
<td>research and development, a period starting on the date the initiating notice</td>
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<td></td>
<td>is received by Inland Revenue and ending two years after the latest date to</td>
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<td></td>
<td>provide a return of income* for the relevant tax year.</td>
</tr>
<tr>
<td>Notice of disputable decision or a notice revoking or varying a disputable decision</td>
<td>(a) Two months starting on the date of issue of the initiating notice, unless</td>
</tr>
<tr>
<td>(other than an assessment)</td>
<td>(b) or (c) applies;</td>
</tr>
<tr>
<td></td>
<td>(b) For a NOPA to which (c) does not apply, four months starting on the date</td>
</tr>
<tr>
<td></td>
<td>of issue of the initiating notice;</td>
</tr>
<tr>
<td></td>
<td>(c) If the NOPA relates solely to the amount of a tax credit for expenditure on</td>
</tr>
<tr>
<td></td>
<td>research and development, a period starting on the date the NOPA is received</td>
</tr>
<tr>
<td></td>
<td>by Inland Revenue and ending on the later of —</td>
</tr>
<tr>
<td></td>
<td>(i) Four months after the date of the initiating notice;</td>
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<td></td>
<td>(ii) Two years after the latest date to provide a return of income* for the</td>
</tr>
<tr>
<td></td>
<td>relevant tax year.</td>
</tr>
<tr>
<td>Disclosure notice, a notice issued by the CIR rejecting an adjustment proposed by a</td>
<td>Two months starting on the date of issue of the initiating notice.</td>
</tr>
<tr>
<td>disputant, or a disputant’s statement of position</td>
<td></td>
</tr>
</tbody>
</table>

* If the taxpayer is a member of an internal software development group to which s 68E of the TAA applies, the latest date for providing a return means the latest date for any member of the group. See s 89AB of the TAA.

“Tax law” means a provision of the Inland Revenue Acts (as listed in the Schedule to the TAA), an Order in Council or a regulation made under another tax law, a non-disputable decision, or a provision of the Accident Rehabilitation and Compensation Insurance Act 1992 (ARCI A 1992), Accident Insurance Act 1998 (AIA 1998), or Injury Prevention, Rehabilitation, and Compensation Act 2001 (IPRCA 2001), as they relate to the filing of a tax return or tax form.

“Tax position” means a position or approach regarding tax under one or more tax laws, including a position or approach in relation to:

(a) A liability for an amount of tax, or the payment of an amount of tax;
(b) An obligation to deduct or withhold an amount of tax, or the deduction or withholding of an amount of tax;
(c) A right to a tax refund, or to claim or not to claim a tax refund;
(d) A right to a credit of tax, or to claim or not to claim a credit of tax;
(e) The provision of a tax return, or the non-provision of a tax return;
(f) The derivation of an amount of income or exempt income or a capital gain, or the inclusion or non-inclusion of an amount in income;
(g) The incurring of an amount of expenditure or loss, or the allowing or denying as a deduction of an amount of expenditure or loss;
(h) The availability or use of a tax loss component or loss balance;
(i) The attaching of a credit of tax, or the receipt of or lack of entitlement to receive a credit of tax;
(j) The balance of a tax account or memorandum account of any type or description, or a debit or credit to such a tax account;
(k) The estimation of the provisional tax payable;
(l) Whether the taxpayer must request or respond to an income statement [see 1270.75];
(m) The application of s 33A(1) of the TAA (individuals not required to file tax returns);
(n) A right to a tax credit; or
(o) The amount of subsidy claimed under s RP 4 by a listed PAYE intermediary.

260.15 Meaning of “response period”
“Response period” is a defined term [see 260.10 for the definition].

In TIB vol 12:6 (June 2000) at 14-15, the CIR gave his interpretation of when a response period commences and ends.

Note: The definition of “response period” has changed since this interpretation was issued.

The date of issue of a notice (eg a NOPA) is the date that the notice is sent or posted (ie the date that the notice physically leaves Inland Revenue or the taxpayer, for delivery to the post office or an external mailbox). Generally, this will be determined by the date on the notice. However, this presumption is arguable.

If a taxpayer sends a notice by fax, the date of issue is the date the notice is transmitted.

The response period is the two month period starting on the date of issue of the notice. The response period starts on (and includes) the date of issue. “Month” is defined in the Interpretation Act 1999 as a calendar month. The last day of the two month period is therefore the day which numerically precedes the day of issue in the second month following the month of issue. For example, if a NOPA was posted by Inland Revenue on 5 October, the response period ends on 4 December. 4 December would be the last day the taxpayer could respond to that notice.

The exception to this rule is that if a notice were issued on 29, 30 or 31 December, the last day of the response period would be 28 February in all cases. In a leap year, if a notice were issued on 30 or 31 December, the last day of the response period would be 29 February in both cases.

If the last day of a response period falls on a weekend or statutory holiday, the last day of the response period is the next working day.

260.20 Notices of proposed adjustment [TAA, ss 89B, 89C, 89D, 89DA]
“Notice of proposed adjustment” (NOPA) is a defined term [see 260.10].

The CIR may issue one or more notices of proposed adjustment in respect of a tax return or an assessment. The CIR may issue one NOPA in relation to more than one return period if, in the CIR’s opinion the adjustments relate:
(a) Exclusively to the same issues or arrangements; or
(b) Substantially to the same issues, and the issue of one notice is likely to expedite the issue of the assessments for all of the returns.

The CIR may issue a notice of proposed adjustment in relation to more than one return period, more than one issue, and more than one tax type. The CIR may not issue a NOPA if the proposed adjustment is already the subject of a challenge, or after the expiry of the time bar (under ss 108 to 108B of the TAA), that applies to the assessment [TAA, s 89B].

The CIR cannot make an assessment until a NOPA has been issued, unless:

(a) The assessment corresponds with a tax return that has been provided by the taxpayer;
(b) The taxpayer has provided a tax return that, in the CIR’s opinion, appears to contain a simple or obvious mistake or oversight, and the assessment merely corrects the mistake or oversight;
(c) The assessment corrects a tax position previously taken by the taxpayer in a way or manner agreed by the CIR and the taxpayer;
(d) The assessment reflects an agreement reached between the CIR and the taxpayer;
(e) The assessment is made in relation to a matter for which the material facts and relevant law are identical to those for an assessment of the taxpayer for another period that is at the time the subject of court proceedings;
(f) The CIR has reasonable grounds to believe that a notice may cause the taxpayer or an associated person to leave New Zealand or to take steps to move or hide assets, making it harder for the CIR to collect the tax from the taxpayer;
(g) The CIR has reasonable grounds to believe that the taxpayer has been involved in fraudulent activity;
(h) The assessment corrects a tax position previously taken by a taxpayer that, in the opinion of the CIR, is or is the result of a vexatious or frivolous act by the taxpayer;
(i) The assessment is made as a result of a direction or determination of a Court or the TRA;
(j) The taxpayer has not provided a tax return when and as required by a tax law;
(k) The assessment is issued following the failure by a taxpayer to withhold or deduct an amount required to be withheld or deducted by a tax law, or to account for an amount withheld or deducted in the manner required by a tax law;
(l) The taxpayer is entitled to issue a NOPA in respect of a tax return, and has done so;
(m) The assessment corrects a tax position taken by the taxpayer or an associated person as a consequence or result of an incorrect tax position taken by another taxpayer, and the CIR has made, or is able to make, an assessment for that other taxpayer for the correct amount of tax payable by that other taxpayer;
(n) The assessment corrects a tax position taken by the taxpayer in relation to a tax position taken by a look-through company in a return of income under s 42B of the TAA, and the CIR and the company have completed the disputes process for that return of income and that tax position;
(o) The assessment results from an income statement [see 1270.75];
(p) The assessment extinguishes all or part of a taxpayer’s tax loss in accordance with TAA, s 177C(5) [see 480.40]; or
(q) The assessment includes a calculation by the CIR of a tax credit identified in subparts MA to MF and MZ [TAA, s 89C].

In Bank of New Zealand v Commissioner of Inland Revenue (2006) 22 NZTC 19,822 (HC), the CIR disallowed net losses incurred by BNZ Investments Ltd (BNZI) and issued it with amended assessments. Relying on s 89C(k) of the TAA (as explained in item (m) above), the CIR also issued assessments to Bank of New Zealand Ltd reversing losses previously transferred to it from BNZI, without first issuing NOPAs. The High Court held that the correct tax position referred to in s 89C(k) of the TAA is the one determined by the CIR. In order to be correct, the tax position does not first have to have been confirmed correct by agreement.
between the CIR and the taxpayer, by the disputes process, or by a hearing authority. BNZ can challenge the assessment by issuing a NOPA.

If the CIR issues a notice of assessment to a taxpayer, and the CIR has not previously issued a NOPA to the taxpayer in respect of the assessment, the taxpayer may issue a NOPA in respect of the assessment. From 1 April 2011, this does not apply to the extent that the assessment takes into account amounts arising under subpart HB (look-through companies) [TAA, s 89D]. The NOPA must be issued within the applicable response period [see 260.10].

Where a taxpayer has not furnished a return of income for an assessment period, the taxpayer may dispute the assessment made by the CIR only by furnishing a return of income for that period. For this purpose, s 33(2) of the TAA does not apply. In *Allen v Commissioner of Inland Revenue* [2006] NZSC 19, [2006] 3 NZLR 1, (2006) 22 NZTC 19,827, the Supreme Court held that in order to dispute a default assessment issued by the CIR, a taxpayer must file an income tax return and issue a NOPA within the four-month response period. Filing the return alone is not sufficient.

A taxpayer who receives an income statement that the taxpayer considers to be incorrect and who has not furnished an amended income statement, may dispute a deemed assessment, only by furnishing an amended income statement for the assessment period [TAA, s 89D].

A taxpayer may issue a NOPA in respect of an assessment made by the taxpayer for a tax year or a GST return period, except:

(a) To the extent to which the assessment takes into account amounts arising under subpart HB;
(b) If the CIR has previously issued a NOPA to the taxpayer in respect of the assessment.

A look-through company may issue a NOPA for a return it makes under s 42B of the TAA, for a tax year if the CIR has not previously issued a NOPA to the taxpayer for the return. A NOPA issued by a taxpayer is not effective unless it is issued within the response period [see 260.15; TAA, s 89DA]

If the CIR issues a notice of disputable decision that is not a notice of assessment and the notice of disputable decision affects the taxpayer, the taxpayer, or any other person who has the standing under a tax law to do so on behalf of the taxpayer, may issue a NOPA in respect of the disputable decision. The NOPA must be issued within the applicable response period.

A taxpayer who has not provided a GST return for a GST period may not dispute the assessment made by the CIR except by providing a GST return for that period. For this purpose, the return is not required to contain a notice of assessment as normally required by s 16(3) of the GSTA 1985.

### 260.25 Small claims jurisdiction of TRA [TAA, s 89E (repealed)]

Before the small claims jurisdiction was abolished, effective from 29 August 2011, a disputant who either issued a NOPA or rejected a NOPA issued by the CIR, and the amount in dispute was $30,000 or less, was able to elect, in their NOPA (or notice of rejection), that any unresolved dispute arising from that NOPA could be heard by the TRA acting in its small claims jurisdiction. If the disputant made such an election, the TRA’s decision was irrevocable and bound the disputant.

### 260.30 Content of notice of proposed adjustment [TAA, s 89F]

A notice of proposed adjustment (NOPA) must be in the prescribed form and must contain sufficient detail of the matters listed below to identify the issues arising between the CIR and the disputant.

A NOPA issued by the CIR must:

(a) Identify the adjustments proposed to be made to the assessment;
(b) Provide a concise statement of the key facts and the law in sufficient detail to inform the disputant of the grounds for the CIR’s proposed adjustments; and
(c) State how the law applies to the facts.

A NOPA issued by a disputant (IR770) must:

(a) Identify the adjustments proposed to be made to the assessment;
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(b) Provide a concise statement of the key facts and the law in sufficient detail to inform the CIR of the
grounds for the disputant’s proposed adjustments;
(c) State how the law applies to the facts; and
(d) Include copies of the documents that the disputant is aware of, at the time the NOPA is issued, that
are significantly relevant to the issues arising between the CIR and the disputant.


260.35 Response notice [TAA, s 89G]

To reject a proposed adjustment, the recipient of the notice of proposed adjustment (NOPA) must, within
two months of the date of issue of the NOPA, notify the issuer that the adjustment is rejected by issuing a
response notice.

A response notice (IR771) must state concisely:
(a) The facts or legal arguments in the NOPA that the issuer considers are wrong;
(b) Why the issuer considers those facts or legal arguments are wrong;
(c) Any facts and legal arguments relied on by the issuer;
(d) How the legal arguments apply to the facts; and
(e) The quantitative adjustments to any figure referred to in the NOPA that result from the facts and legal
arguments relied on by the issuer.

The CIR does not have the power to determine whether a taxpayer’s response notice complies with the
relevant statutory requirements by rejecting that notice and applying the deemed acceptance provisions
[see TES 72 (July 2008) 1164]. Where a taxpayer wishes to challenge the CIR’s conclusion that a response
notice is non-compliant, the appropriate course is to issue challenge proceedings in the procedurally correct
manner and within the statutory time limit: Commissioner of Inland Revenue v Alam [2009] NZCA 273.

For the requirements of a response notice for disputes commencing before 1 April 2005 see

260.40 Deemed acceptance [TAA, s 89H]

If a disputant does not reject an adjustment contained in a notice of proposed adjustment (NOPA) issued by
the CIR within the two-month response period, the disputant is deemed to accept the proposed adjustment
and may not challenge it [see 260.45]. If the CIR does not reject an adjustment contained in a NOPA issued
by the disputant within the two month response period, the CIR is deemed to accept the proposed adjustment
and must issue a notice of assessment to the disputant accordingly [see 260.45].

Where the disputant accepts all or part of the CIR’s notice in writing or the disputant does not, within the
two-month response period, reject in writing all or part of the CIR’s response notice, the disputant is deemed
to accept the matters specified in the CIR’s notice and may not challenge it [see 260.45]. In those
circumstances, the CIR’s response notice is deemed, for the purposes of the exceptional circumstances rules
[see 260.50], to be a NOPA.

If the CIR fails to issue a challenge notice in accordance with s 89P of the TAA, [see 260.50], the CIR is
deemed to accept an adjustment proposed by the disputant or the disputant’s statement of position and TAA,
s 89J applies [see 260.45]. This applies for disputes initiated by a taxpayer issuing a NOPA after 29 August
2011.

A NOPA must be issued under s 89D of the TAA within the applicable response period before it can be
deemed accepted under s 89H of the TAA: TRA No 37/09 [2011] NZTRA 04.

260.45 When disputant may not challenge adjustment [TAA, ss 89I, 89J]

A disputant may not challenge an adjustment proposed by the CIR if the disputant accepts the adjustment in
writing or is deemed to accept the adjustment, and s 89K of the TAA (exceptional circumstances rules) do
not apply [see 260.50]. The CIR must include or take account of each proposed adjustment that is accepted
or deemed accepted by a disputant in a notice of assessment issued to the disputant [TAA, s 89I].
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If the CIR accepts or is deemed to accept an adjustment proposed by a disputant, and s 89L of the TAA (exceptional circumstances rules) do not apply [see 260.50], the CIR must include or take account of the adjustment in:

(a) A notice of assessment issued to the disputant; and
(b) Any further notice of assessment or further amended assessment issued to the disputant.

However, the CIR does not have to issue a notice of assessment or an amended assessment that includes or takes into account an adjustment that the CIR has accepted, or is deemed to have accepted, if the CIR considers that the disputant was fraudulent or wilfully misled the CIR in relation to the adjustment [TAA, s 89J].

260.50 Extension of time for exceptional circumstances [TAA, ss 89K, 89L]

(1) Affecting the disputant [TAA, s 89K]

Where the CIR considers that an exceptional circumstance has prevented a disputant from rejecting a proposed adjustment, issuing a notice of proposed adjustment (NOPA), or issuing a statement of position within the applicable response period, the CIR may treat the notice as if it had been received within the response period. This only applies if the disputant sends the CIR the required notice as soon as is reasonably practical after becoming aware of their failure to respond within the response period.

The actions referred to above are:

(a) Rejecting, within the response period, an adjustment contained in a NOPA issued by the CIR;
(b) Issuing, within the response period, a NOPA under TAA, s 89D or 89DA in respect of a disputable decision;
(c) Issuing, within the response period, a statement of position.

The required notice is as follows:

(a) A notice rejecting an adjustment proposed by the CIR in a NOPA specifying the matters required to be shown in a response notice;
(b) A NOPA in respect of a disputable decision specifying the matters required to be shown in a NOPA; or
(c) A statement of position.

If these conditions are met, the CIR may issue a notice in favour of the disputant stating that the disputant’s rejection of the CIR’s NOPA, the disputant’s NOPA, or the disputant’s statement of position, is to be treated for the purposes of the disputes procedures as if it had been given within the applicable response period.

The CIR may accept a late response notice or NOPA even if the CIR has already issued a notice of disputable decision. In these circumstances, the notice of disputable decision is to be deemed not to have been issued.

An “exceptional circumstance” is defined as:

(a) An event or circumstance beyond the control of a disputant that provides the disputant with a reasonable justification for not rejecting an adjustment, not issuing a NOPA, or not issuing a statement of position within the response period; or
(b) A disputant is late in issuing a NOPA, response notice or statement of position, but the CIR considers that the lateness is minimal or results from statutory holidays falling in the response period.

An act or omission of an agent of a disputant is not an exceptional circumstance unless:

(a) It was caused by an event or circumstance beyond the control of the agent that could not have been anticipated, and its effect could not have been avoided by complying with accepted standards of business organisation and professional conduct; or
(b) The agent is late in issuing a NOPA, response notice or statement of position, but the CIR considers that the lateness is minimal, or results from statutory holidays falling in the response period.

If the CIR decides not to issue a notice in favour of the disputant, the CIR must issue a refusal notice within one month of the disputant sending the required notice defined above. A refusal notice is deemed to have
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been sent after one month if one is not, in fact, sent. The disputant may challenge a refusal notice by filing proceedings, in accordance with the TRA Regs 1998, within two months of the notice’s issue. For the purposes of the TRA Act 1994 and the TRA Regs 1998, a refusal notice is treated as a disputable decision and the challenge is treated as a challenge under TAA, Part 8A.

In Commissioner of Inland Revenue v Wilson (1996) 17 NZTC 12,512 (CA), the Court of Appeal indicated that the CIR should use the following approach when considering whether to accept a late objection:

“If a late objection application is made the Commissioner has to weigh and balance the relevant public policy considerations applicable at that time in the particular circumstances of the case. If particular factors are material to that decision then the weight to be given to the various factors and the overall balancing judgment fall within the wide discretion understandably reposed in the Commissioner.

“The inquiry … calls for some explanation from the taxpayer of the failure to make timely objection and, where there is significant delay involved, the reasons for the failure to make the application earlier. Depending on the circumstances, it may be relevant to consider whether the failures or failure were due to inadvertence, negligence, an agent’s action or a deliberate decision by the taxpayer, as the case may be. Next, the apparent merits of the proposed objection may, and often will be, a relevant factor. … In some circumstances the inadequacy of the explanation for lateness may make it unnecessary to consider the apparent strength of the proposed objection. In many circumstances, however, it will be a material factor to be weighed.”

Although this decision relates to the antecedent of s 89K of the TAA (ITA 1976, s 30), the same principles are likely to apply.

In Wood v Commissioner of Inland Revenue (1999) 19 NZTC 15,255 (HC), the taxpayer sought a judicial review of the CIR’s decision not to accept a late objection (under s 30 of the ITA 1976), on the grounds that the CIR had failed to consider certain matters. The Court held that the CIR had, in fact, taken these matters into account. The issue for the Court was not the correctness of the decision but whether the CIR had considered the relevant matters in reaching this decision. The Court has no power to intervene unless the CIR is shown to have acted wrongly.

(2) Affecting the CIR [TAA, s 89L]

If the CIR considers that an exceptional circumstance has prevented the CIR from rejecting an adjustment within the response period, the CIR may apply to the High Court for an order allowing the CIR to issue a notice rejecting an adjustment proposed by a taxpayer that the CIR has accepted or is deemed to have accepted. The CIR must apply to the High Court:

(a) Before issuing a notice of assessment including the adjustment; or
(b) Relying on s 108(2) of the TAA (which provides an extension of the four year time bar for a fraudulent or willfully misleading tax return) or s 108A(3) of the TAA (which provides an extension of the four year time bar for failure to make full disclosure in a GST return).

The High Court may make an order on such terms as the Court deems fit or decline to make an order. The CIR may apply to the High Court for an order allowing the CIR to issue a challenge notice past the four year period provided for in TAA, s 89P(1) [see 260.67] if:

(a) The CIR considers that an exceptional circumstance applies or has prevented the CIR from issuing the challenge notice within the four years; and
(b) The CIR applies within the four years.

This applies for disputes initiated by a taxpayer issuing a NOPA after 29 August 2011.

The High Court may either make an order on such terms as the Court deems fit or decline to make an order. An “exceptional circumstance”, for the purposes of a High Court application, is an event or circumstance beyond the control of the CIR or an officer of Inland Revenue that provides the CIR with a reasonable justification for not rejecting an adjustment proposed by a disputant within the response period.
260.55 Disclosure notices [TAA, s 89M]

The CIR must issue a disclosure notice in respect of a notice of proposed adjustment (NOPA) to a disputant at the same time as or after the CIR or the taxpayer issues the NOPA. The CIR may not issue a disclosure notice in respect of a NOPA until the disputes process has been completed [see 260.60], and the CIR has already issued a notice of disputable decision that includes, or takes account of, the adjustment proposed in the NOPA.

Unless the disputant has issued a NOPA, when issuing a disclosure notice the CIR must:

(a) Provide the disputant with the CIR’s statement of position; and

(b) Include in the disclosure notice a reference to s 138G of the TAA and a statement explaining the effect of the evidence exclusion rule.

The CIR’s statement of position in the prescribed form must, with sufficient detail to fairly inform the disputant:

(a) Give an outline of the facts on which the CIR intends to rely;

(b) Give an outline of the evidence on which the CIR intends to rely;

(c) Give an outline of the issues that the CIR considers will arise; and

(d) Specify the propositions of law on which the CIR intends to rely.

If the CIR issues a disclosure notice to a disputant, the disputant must issue the CIR with the disputant’s statement of position within the response period for the disclosure notice. A disputant’s statement of position in the prescribed form must, with sufficient detail to fairly inform the CIR:

(a) Give an outline of the facts on which the disputant intends to rely;

(b) Give an outline of the evidence on which the disputant intends to rely;

(c) Give an outline of the issues that the disputant considers will arise; and

(d) Specify the propositions of law on which the disputant intends to rely.

The CIR must issue a statement of position in response to the disputant’s statement of position if the CIR is not required to issue one when issuing a disclosure notice.

The evidence referred to in the CIR’s and the disputant’s statement of position means the available documentary evidence on which the person intends to rely. A list of potential witnesses (named or unnamed) does not have to be provided at this stage. A disputant who does not issue a statement of position within the response period is treated as follows:

(a) If the CIR proposed the adjustment, the disputant is treated as having accepted the CIR’s NOPA or statement of position; or

(b) If the disputant proposed the adjustment, the disputant is treated as having not issued a NOPA.

The CIR may, within the response period for a disputant’s statement of position, provide the disputant with additional information in response to the disputant’s statement of position. The CIR must provide the additional information as far as possible in the manner required for the CIR’s statement of position. The additional information provided by the CIR is deemed to form part of the CIR’s statement of position.

However, the provision allowing the CIR to provide a disputant with additional information does not allow the CIR to change the legal basis upon which the CIR makes a disputable decision [TAA, s 89M(8)]: TRA Case W18 (2003) 21 NZTC 11,175.

The CIR may apply to the High Court for more time to reply to a disputant’s statement of position if the CIR considers it is unreasonable to reply within the response period, because of the number, complexity, or novelty of matters raised in the disputant’s statement of position. The CIR must apply for the disputant’s statement of position before the expiry of the response period.

The disputant may apply to the High Court for more time within which to reply to the CIR’s statement of position if the disputant considers it unreasonable to reply within the response period, because the issues in dispute had not previously been discussed between the CIR and the disputant. The disputant must apply
before the expiry of the response period for the CIR’s statement of position. The High Court must, in considering an application from the disputant, have regard to the purpose of the disputes procedures and the conduct of the parties to the dispute [see 260.05].

In *Chapman v Commissioner of Inland Revenue* (2004) 21 NZTC 18,474 (HC), the High Court granted a one-month extension of time under s 89M(11) of the TAA for the taxpayers to prepare their statements of position even though much of the material in the CIR’s statement of position was familiar to them. The Court held that the purposes of s 89A of the TAA would be furthered if the taxpayers had additional time to prepare their statements, since the CIR’s statement of position was a substantial document.

The CIR and a disputant may agree to additional information being added, at any time, to either of their statements of position. The additional information provided by the CIR or a disputant is deemed to form part of the provider’s statement of position.

### 260.60 Disputes process to be completed [TAA, s 89N]

If a NOPA has been issued and the dispute has not been resolved by agreement between the CIR and the disputant, the CIR may not (except in the circumstances listed below) amend an assessment under s 113 of the TAA [see 60.70] until one of the following has occurred:

(a) The CIR or the disputant accepts a NOPA, response notice, or statement of position issued by the other;

(b) The CIR considers a statement of position issued by the disputant.

The circumstances in which the CIR may amend an assessment before the disputes process has been completed are:

(a) The CIR notifies the disputant that, in the CIR’s opinion, the disputant has committed a tax-related offence that has delayed the completion of the disputes process;

(b) The CIR has reasonable grounds to believe that the disputant or an associated person may hide or dispose of the disputant’s assets to avoid or delay the collection of tax;

(c) The CIR has reasonable grounds to believe that an associated person (under the provisions of the 1988 version of subpart YB) of the disputant may hide or dispose of the disputant’s assets to avoid or delay the collection of tax;

(d) The disputant has begun judicial review proceedings in relation to the dispute;

(e) An associated person (under the provisions of the 1988 version of subpart YB) of the disputant has begun judicial review proceedings in relation to another dispute with the CIR involving similar issues;

(f) The disputant fails to comply with a statutory request by the CIR for information during the disputes process;

(g) The disputant elected before 29 August 2011 to have the dispute heard in the small claims jurisdiction of the TRA;

(h) The disputant and the CIR agree in writing that the dispute would be resolved more efficiently by the court or TRA;

(i) The disputant and the CIR agree in writing to suspend the dispute process until a test case [see 260.65] has been decided.

Despite the above restriction on amending an assessment, the CIR may apply to the High Court for an order that allows more time for the completion of the disputes process, or for an order that completion of the disputes process is not required. This application must be made within the time period that the CIR is required to make an amended assessment. The period of time during which the CIR must make an amended assessment is the total of:

(a) The period of time within which the CIR would, in the absence of the application, be required to make the amended assessment;
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260.65 Test cases [TAA, s 89O]

A disputant and the CIR may agree in writing to suspend the disputes process in relation to a dispute pending the outcome of a test case. A dispute may be suspended where there is significant similarity between the facts and questions of law in the dispute and the facts and questions of law in the test case. A test case is a challenge by another taxpayer that the CIR has designated as a test case.

The period of suspension is the period from the date of the written agreement to the date of the Court’s decision in the test case, the date on which the test case is otherwise resolved or the date on which the dispute is otherwise resolved, whichever is earlier. Once the test case has been resolved, the CIR may make an assessment or take other action in relation to a suspended dispute that is consistent with the resolution of the test case.

The amended assessment must be made, or action performed, by the later of the following days:

(a) Sixty days after the last day of the suspension;
(b) The last day of the period that:
   (i) Begins on the day following the day by which the CIR would, if the disputes process were not suspended, be required to make the amended assessment or perform the action; and
   (ii) Contains the same number of days as the period of suspension.

260.67 Challenge notice for taxpayer-initiated disputes [TAA, s 89P]

The CIR must issue a challenge notice to a disputant within four years of the disputant issuing a NOPA unless:

(a) The High Court makes an order under TAA, s 89L(2B)(a) allowing the CIR to issue a challenge notice after four years due to exceptional circumstances; or
(b) The CIR considers under s 89J(2) that the disputant was fraudulent or misled the CIR in relation to the NOPA.

The CIR does not have to issue a challenge notice to the extent to which the dispute has ended.

A challenge notice may not be issued before the CIR issues a statement of position, unless one or more of TAA, s 89N(1)(c)(i) to (ix) applies [see 260.60].

A challenge notice must state that the CIR will not be issuing an amended assessment that includes or takes into account the adjustment proposed by the disputant, and that a challenge may proceed.

This applies for a dispute initiated by a taxpayer issuing a NOPA after 29 August 2011.

260.70 Challenge to assessment [TAA, s 138B]

A disputant may challenge an assessment by commencing proceedings in the TRA or the High Court if:

(a) The assessment includes an adjustment proposed by the CIR which the disputant or their look-through company has rejected within the response period. Where the assessment is an amended assessment, the adjustment must impose a fresh liability or increase an existing liability. The disputant must file the proceedings, in accordance with the TRA Regulations 1994 (or any regulations made in substitution) or High Court Rules, within the relevant response period.

(b) The assessment was the subject of an adjustment proposed by the disputant which the CIR has rejected by written notice within the response period, and the disputant is subsequently issued with an amended assessment. The disputant must file the proceedings, in accordance with the TRA Regulations 1994 (or any regulations made in substitution) or High Court Rules, within the relevant response period.
The assessment was the subject of an adjustment, proposed by the disputant, which the CIR has rejected by written notice within the response period, and the CIR has issued a challenge notice to the disputant. The disputant must file the proceedings in accordance with the TRA Regulations 1998 (or any regulations made in substitution) or High Court rules within two months. Despite (c), a disputant may challenge an assessment by commencing proceedings in the TRA or the High Court if:

(a) The assessment was the subject of an adjustment notified to the CIR in writing;

(b) The CIR has issued a challenge notice to the disputant;

(c) The adjustment:

(i) Is in relation to a matter for which the material facts and relevant law are identical to those for another assessment for the taxpayer, for another period, that is at the time of proposing the adjustment the subject of court proceedings; or

(ii) Corrects a tax position taken by the taxpayer or an associated person as a consequence or result of an incorrect tax position taken by another taxpayer and, at the time of proposing the adjustment, the incorrect tax position taken by the other taxpayer is the subject of, or was the subject of, court proceedings; and

(d) The disputant files the proceedings, in accordance with the TRA Regulations 1998 (or any regulations made in substitution) or High Court rules within two months.

260.75 Challenge to disputable decision other than assessment [TAA, ss 138C, 138F]

A disputant may challenge a disputable decision that is not an assessment by commencing proceedings in the TRA or the High Court if the disputable decision was the subject of an adjustment proposed by the disputant which the CIR has rejected. The disputant must file the proceedings in accordance with the TRA Regulations 1994 or the High Court Rules, within the response period for the notice from the CIR rejecting the proposed adjustment [TAA, s 138C].

A disputant may challenge an assessment made by the CIR that takes account of or relies on a disputable decision (other than an assessment), whether or not the disputant has issued a notice of proposed adjustment (NOPA) in respect of the disputable decision. The disputant may not challenge such an assessment if the disputant has issued a NOPA in respect of the disputable decision and the disputant’s grounds for challenging the assessment are the same grounds, or substantially the same as the grounds, that were specified in the NOPA [TAA, s 138F].

260.80 Extension of time to commence challenge [TAA, s 138D]

If the TRA or the High Court considers that exceptional circumstances apply, the TRA or the High Court may, on application by a disputant, allow the disputant to commence a challenge to a notice of a disputable decision after the response period. An “exceptional circumstance” is defined as an event or circumstance beyond the control of a disputant that provides the disputant with a reasonable justification for not commencing a challenge to a disputable decision within the response period. An act or omission of an agent of a disputant is not an exceptional circumstance unless the act or omission was caused by an event or circumstance beyond the control of the agent that could not have been anticipated and the effect of which could not have been avoided by compliance with accepted standards of business organisation and professional conduct.

The importance of challenging a notice of disputable decision within the statutory time period was highlighted by the case Milburn New Zealand Ltd v Commissioner of Inland Revenue (1998) 18 NZTC 14,005 (HC). In that case the finance manager of the taxpayer company mistakenly believed that, because a challenge had already been made to a reassessment of the company’s 1992 income tax, and the same ground for objection existed, it was not necessary for the company to separately challenge a reassessment of the company’s 1993 income tax. As a result, a challenge was not made within the two-month response period. On realising its
mistake, the company applied to the High Court under s 138D of the TAA to make a late challenge on the
grounds of exceptional circumstances. The Court, while sympathetic, declined the application because the
failure to challenge the reassessment was the result of a mistake, not the result of an event or circumstance
beyond the control of the disputant.

In Commissioner of Inland Revenue v Fuji Xerox New Zealand Ltd (2001) 20 NZTC 17,470 (CA), the Court
considered whether the sending of GST notices of assessment by Inland Revenue to the taxpayer’s business
address, rather than to the taxpayer’s agent, constituted an exceptional circumstance that justified the
commencing of a challenge outside the response period. The CIR had commenced an audit of the taxpayer’s
income tax and GST affairs, and the taxpayer had appointed KPMG to act on its behalf. However, KPMG
was not the taxpayer’s agent for GST matters. Up to the point at which the assessments were issued, all
correspondence relating to the audit had been sent by Inland Revenue directly to KPMG. However, the
assessments themselves were sent to the taxpayer because that was the address that had been advised by the
taxpayer for service. The taxpayer failed to identify the significance of the assessments and paid the tax owing
as per company policy. By the time KPMG and the taxpayer realised what had happened, the response period
had expired. The taxpayer applied under s 138D of the TAA to commence a challenge outside the response
period. The Court found that the sending of the assessment notices to the taxpayer’s address was not an
exceptional circumstance as defined in s 138D. That act was not in any real sense causative of the respondent’s
default. The real cause of the default was the systemic and human failures of the taxpayer itself.

260.85 No right of challenge in certain cases [TAA, s 138E]
The following decisions or matters cannot be challenged:

(a) A decision of the CIR under a tax law to enlarge or extend the time for giving notice, making an
application, furnishing a tax return, or doing any other act, matter, or thing; or

(b) A decision of the Minister of Finance under a tax law, or an act, matter, or thing done or omitted by
the Minister under a tax law; or

(c) A matter in respect of which provision is made by a tax law:
   (i) For a challenge or objection to the matter to be heard and determined by;
   (ii) For the matter to be inquired into, considered, reported on, heard, decided, determined, or
        otherwise dealt with by; or
   (iii) For the matter to be the subject of any recommendation of,
         a special committee, tribunal, or authority (other than the TRA) established in that behalf or a person
         or official (other than the CIR); or

(d) A valuation or apportionment made by the Valuer-General or a registered valuer under the Valuation
of Land Act 1951 or the ITA 2007; or

(e) A matter that is left to the discretion, judgment, opinion, approval, consent, or determination of the
CIR by a provision in:
   (i) The PAYE rules;
   (ii) The provisional tax rules;
   (iii) Any of CD 15, CD 19, HD 2, HD 3(2), HD 5(4), HD 15, HD 24, HD 26 to HD 29,
        LA 6 to LA 8, LJ 1 to LJ 7, RD 3, RM 2 to RM 4, RM 6, RM 8 and RM 10; and ss 33, 89,
        92A, 139 (as it applies to unpaid tax for periods before 1 April 1997) and 184 of the TAA;
   (iv) Any of ss 21 to 23, 34B, 36 to 46, 58, 62, 63, 78B, 78C, 80, 88, 89C, 89K, 89L, 89M,
        89N(1)(c)(viii), 89N(3), 92, 106, 107, 108A, 108B, 109, 110, 111, 113, 114,
        120A to 120U, 138I(2B), 138N, 142A, 142C, 146, 150A, 157, 160, 166, 166B, 167,
        174AA, 176, 177, 177A to 177D, 183A, 183D, 183F and 225B of the TAA;
   (v) Any of Parts 1 to 3 of the KiwiSaver Act 2006;
   (vi) Any of Parts 4, 6, 7 and 11 (other than s 76) of the GSTA; or
(f) A binding ruling made under Part 5A of the TAA [see 115 BINDING RULINGS]; or
(g) A status ruling made under s 91GA of the TAA [see 115.70]; or
(h) A matter in respect of which a tax law provides that there shall be no right of objection or challenge to the decision of the CIR.

Any of restrictions (a) to (h) above may be overruled by a tax law or other law that expressly confers a right of objection or challenge in respect of a decision made by any person.

A decision by the CIR to dispense with the statutory disputes procedure (in this case under s 89C(e) of the TAA) is not open to challenge, by virtue of s 138E(1)(e)(iv) of the TAA: *Hieber v Commissioner of Inland Revenue* (2002) 20 NZTC 17,562 (HC).

**260.90 Application to strike out proceedings** [TAA, s 138H]

The CIR may apply to the TRA or the High Court to strike out a challenge commenced by a disputant if the CIR considers that the disputant has failed to comply with any of the requirements of s 89M of the TAA (disclosure notices) [see 260.55] or s 138B of the TAA (when disputant may challenge) [see 260.70].

**260.95 Disputable decisions deemed correct unless challenged or objected to** [TAA, s 109]

Unless it has been objected to (under Part 8 of the TAA) or challenged (under Part 8A of the TAA):

(a) A disputable decision (an assessment or other decision made by the CIR) may not be disputed in Court or in any proceedings on any ground whatsoever; and

(b) Every disputable decision and all of its particulars are deemed to be correct in all respects.

The High Court confirmed in *Commissioner of Inland Revenue v Disputes Tribunal* (1997) 18 NZTC 13,383 (HC), that the Disputes Tribunal has no jurisdiction to hear a claim in relation to money due under the ITA 1994 (now ITA 2007). Once an assessment (or other disputable decision) has been made, its correctness can only be challenged in proceedings on objection or challenge.

In *Rupe v Commissioner of Inland Revenue* (2004) 21 NZTC 18,519 (HC), the High Court confirmed that a taxpayer’s challenge to the validity of assessments for income tax, GST and earner premiums on the basis the Treaty of Waitangi, the New Zealand Bill of Rights Act 1990, and the fact that the taxpayer was a Christian had no basis in law. An assessment can be challenged only through the statutory disputes procedure: s 109 of the TAA and s 29 of the GSTA. There is no reference to the Treaty of Waitangi in the taxation statutes. A person is not exempt from the payment of tax on the basis of Maori sovereignty. The New Zealand Parliament has the right to enact legislation applying to all persons in New Zealand. There is no juridical basis to refuse to pay tax because one is a Christian.

**260.100 Exclusion of evidence** [TAA, s 138G]

If the CIR issues a disclosure notice to a disputant, and the disputant challenges the disputable decision, the CIR and the disputant may raise in the challenge only the issues and the propositions of law that are disclosed in the CIR’s and disputant’s statements of position. This is commonly referred to as the “evidence exclusion” rule. However, the TRA or the High Court may, on application by either party to a challenge, allow the applicant to raise in the challenge new propositions of law, and new issues, if the Court or TRA is satisfied that:

(a) The applicant could not, at the time of delivery of their statement of position, have, with due diligence, discerned those propositions of law or issues; and

(b) Having regard to the purpose of the disputes procedures [see 260.05], and the conduct of the parties, the TRA or the High Court considers that the raising of those propositions of law or issues is necessary to avoid manifest injustice to the CIR or the disputant.

For these purposes, a statement of position includes any additional information that the CIR and the disputant agree (under s 89M(13) of the TAA), to add to the statement of position.
In *TRA Case V9* (2001) 20 NZTC 10,101, it was held that the disputants were barred by s 138G from arguing a point not raised in a response notice to a reassessment. The fact that the disputants prepared the response notice without seeking professional advice was not sufficient reason for the Court to exercise its discretion under the section.

The importance of including all potentially relevant grounds for a challenge in a disputant’s statement of position was reinforced by the decision in *Commissioner of Inland Revenue v Abbatis Properties Ltd* (2002) 20 NZTC 17,805 (CA). The taxpayer claimed (and received), a GST refund of $111,250, which Inland Revenue subsequently decided the taxpayer was not entitled to. The CIR issued an amended assessment to recover the refund, which, together with penalties and interest, ultimately amounted to $388,320. The taxpayer applied for a judicial review of the CIR’s amended assessment, claiming that the assessment was invalid because the taxpayer had never received notice of it. However, the Court of Appeal rejected the application, holding that the taxpayer was estopped from raising any of the issues it sought to raise in judicial review proceedings because they had already been decided with finality by the High Court. There was no evidence that exceptional circumstances were involved. The High Court had already previously determined, in *Abbatis Properties Ltd v Commissioner of Inland Revenue* (2002) 20 NZTC 17,425 (HC), that the failure to give notice did not affect the validity of the assessment. The Court noted that taxpayers who fail to include, in their statement of position, procedural issues arising before the statement was filed do so at their peril.

Section 138G of the TAA does not necessarily exclude an order for discovery. In *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* (2002) 20 NZTC 17,792 (HC), the High Court held that the purpose of s 138G of the TAA is to encourage the disclosure of all relevant information at the statement of position stage and to provide a sanction for non-disclosure. Discovery is a more general process that may disclose documents relevant to the facts and evidence, and the issues arising from them, already stated in the statement of position.

In the dispute resolution process, the CIR and the taxpayer are not restricted by s 138G of the TAA to matters raised in their own statements of position. In *Commissioner of Inland Revenue v Delphi Fishing Co Ltd* (2004) 21 NZTC 18,525 (HC), the CIR was entitled to rely on a ground raised in the taxpayer’s statement of position, even though the matter had not been raised in the CIR’s own statement of position.

### 260.105 Payment of disputed tax [TAA, s 138I]

A disputant is not liable to pay:

(a) The deferrable tax relating to tax in dispute; or
(b) A shortfall penalty that is payable for tax in dispute; or
(c) The interest accruing under Part 7 of the TAA on that tax or shortfall penalty, until the due date for the payment of that deferrable tax.

However, the CIR may require a disputant to pay all tax in dispute that is the subject of the challenge if the CIR considers that there is a significant risk that it will not be paid should the disputant’s challenge not be successful.

After the day of determination of final liability, the CIR must refund or pay to, or apply on behalf of, a disputant whose challenge is successful:

(a) The tax in dispute that a disputant has been required by the CIR to pay, and has so paid; and
(b) Interest accrued on the tax in dispute under Part 7 of the TAA.

Part 7 of the TAA applies to interest calculated on deferrable tax on or after 1 April 1997, irrespective of whether the challenge relates to a tax year before the 1997-1998 tax year. If the challenge relates to the 1996-1997 or an earlier tax year, interest must be calculated on deferrable tax on and after the date that the period of deferral starts.

“Deferrable tax” means:

(a) The amount of tax assessed under a tax law as payable by a taxpayer or disputant; or
(b) GST payable by a taxpayer or disputant on a due date, that the disputant challenges under Part 8A of the TAA.
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“Shortfall penalties” are explained in 1110.85 to 1110.185.

“Day of determination of final liability” means:
(a) The day on which the disputant notifies the CIR that the disputant is discontinuing a challenge;
(b) The day on which the TRA, in its small claims jurisdiction, determined a challenge. Note that the small claims jurisdiction was abolished effective from 29 August 2011;
(c) The day on which the TRA determines a challenge;
(d) The day on which a Court, whether or not by way of appeal, finally determines the challenge, whether in those proceedings or in a subsequent appeal; or
(e) To the extent the CIR concedes a challenge, the day on which the CIR notifies the disputant in writing of the concession [TAA, s 3(1)].

260.110 Determination of challenge does not affect other matters [TAA, s 138K]

The determination of a challenge by the TRA or the High Court relates solely to the matter that is the subject of the disputable decision being challenged. The determination of a challenge does not affect the right of the CIR to make a disputable decision relating to a different matter and to amend the disputable decision being challenged in any way rendered necessary by the later disputable decision.

260.115 Challenging civil penalties [TAA, s 138L]

A taxpayer assessed by the CIR for a civil penalty may challenge the penalty in the same way as a taxpayer may challenge the assessment of tax to which the penalty relates. The taxpayer has the same rights and obligations, in relation to proceedings concerning the penalty, as a person has in relation to proceedings concerning the tax itself. However, a taxpayer has no right to challenge a civil penalty imposed for the late provision of a tax return, the late payment of tax, a civil penalty imposed under s 215 of the KiwiSaver Act 2006 or the percentage applicable to the civil penalty.

A “civil penalty” is:
(a) A late filing penalty;
(b) A late payment penalty;
(c) A shortfall penalty;
(d) A promoter penalty;
(e) A non-electronic filing penalty; or
(f) A civil penalty under s 215 of the KiwiSaver Act 2006.

260.120 Wrong PAYE withholding determination a ground for challenge [TAA, s 138M]

A disputant may dispute a notice of proposed adjustment (NOPA) or challenge an assessment that is issued by the CIR in relation to an amount of tax withheld on the basis of a determination under s RD 3(5) [see 1080.16] on the ground that the determination is wrong in fact or in law.

260.125 Proceedings may be transferred to different hearing authority [TAA, ss 138N, 138O]

If a disputant commences a challenge in the High Court, the CIR may apply to the High Court to have the challenge transferred to the TRA, or the High Court, of its own motion, may transfer the challenge to the TRA.

If a disputant commences a challenge in the TRA, the CIR may apply to the High Court to have the challenge transferred to the High Court.

The High Court may order that any proceedings transferred to it are to be transferred into the Court of Appeal [TAA, s 138N].
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260.125(1)

(1)  **Rules applying before 29 August 2011**
If a disputant commenced a challenge to a disputable decision in the small claims jurisdiction of the TRA and the CIR considered that:
(a)  The proposed adjustment in dispute would or was likely to arise again in future assessments;
(b)  The challenge involved significant legal issues of precedent;
(c)  The facts of the challenge were either not clear or were in dispute; or
(d)  For any reason, the TRA acting in its small claims jurisdiction should not determine the challenge, the CIR could have applied to:
(a)  The TRA, requesting that the challenge be transferred to the general jurisdiction of the TRA; or
(b)  The High Court, requesting that the challenge be transferred to the High Court [TAA, s 138O(1) (repealed)].

The TRA, acting in its small claims jurisdiction, could have required a challenge to be transferred to the TRA’s general jurisdiction or to the High Court if the TRA considered that:
(a)  The challenge involved significant legal issues or precedent;
(b)  The facts of the challenge were either not clear or were in dispute; or
(c)  For any reason, another hearing authority should hear the challenge [TAA, s 138O(2) (repealed)].

260.130  **Powers of hearing authority** [TAA, s 138P]
On hearing a challenge, the TRA or the High Court may:
(a)  Confirm, cancel or vary an assessment, or increase or reduce the amount of an assessment. The amount of the assessment can only be increased to the extent to which the CIR was able to make an assessment of an increased amount at the time the assessment to which the challenge relates was made; or
(b)  Make an assessment which the CIR was able to make at the time the CIR made the assessment being challenged, or direct the CIR to make such an assessment.

If a taxpayer brings a challenge, and proves, on the balance of probabilities, that the amount of an assessment is excessive by a specific amount, the TRA or High Court must reduce the taxpayer’s assessment by that amount.

If the challenge relates to a disputable decision that is not an assessment, the hearing authority must not make or amend the disputable decision, but may direct the CIR to amend the disputable decision to the extent necessary to conform to the decision of the hearing authority.

The CIR must make or amend an assessment or other disputable decision to conform to the hearing authority’s determination, but the CIR is not required to make or amend an assessment or other disputable decision before the resolution of any appeal.

The case of Jarman v Commissioner of Inland Revenue (1980) 4 NZTC 61,553, (1980) 3 TRNZ 677 (HC) established that when an objector complains that he has not been provided with sufficient details of the grounds on which the CIR made the assessment, the TRA has no jurisdiction or authority to order that the CIR supply further particulars of the basis of an assessment. However, Roper J said “The objector is not without a remedy although I must agree that it makes for a cumbersome procedure”.

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In *TRA Case H33* (1986) 8 NZTC 296, (1986) 9 TRNZ 488, the CIR was permitted to raise at a hearing a new but alternative ground for disallowing an objection, since there was no prejudice to the objector whose objection was sufficiently wide to allow the new ground to be challenged.

In *Richardson v Commissioner of Inland Revenue* (1986) 8 NZTC 5,109, (1986) 9 TRNZ 361 (HC), the High Court held that in order for a taxpayer to seek a motion for the review of the exercise of a discretion by the CIR, the taxpayer must satisfy the Court that there was no tenable basis for the facts and conclusions of the CIR. Alternatively, the taxpayer must show that in weighing up the competing factors, the CIR had made errors so fundamental that its conclusions could not stand.

The issue in *TRA Case J16* (1987) 9 NZTC 1,089, (1986) 10 TRNZ 321, was whether an activity was a business. The TRA rejected the argument of the taxpayer that if the objection succeeded, the TRA had no jurisdiction to then consider the deductibility of each component of the losses the taxpayer had claimed on the basis of the business having existed.

In certain circumstances the taxpayer may have available the right to seek a judicial review of an action of the CIR: *Commissioner of Inland Revenue v Lemmington Holdings Ltd* [1982] 1 NZLR 517, (1982) 5 NZTC 61,268 (CA); *Lemmington Holdings Ltd v Commissioner of Inland Revenue* [1984] 2 NZLR 214, (1983) 6 NZTC 61,576 (HC).

The TRA may proceed with a hearing if either party to an objection fails to attend. If the TRA determines an objection in the absence of either party, it may grant a hearing on the application of that party. It may dismiss a frivolous or vexatious objection or objections made solely for the purpose of delay. Proceedings do not abate if an objector dies, as the legal personal representative takes over.

Decisions of the TRA must be given in writing. On the request of the objector, the disputant, or the CIR, a decision may be made at the hearing or at the time when the decision is given. It must state in writing its findings of fact and any reasons in law for its decision.

### 260.135 Test cases [TAA, s 138Q]

The CIR may designate a challenge as a test case if the CIR considers that determination of the challenge is likely to be determinative of all or a substantial number of the issues involved in one or more other challenges. Test cases are heard in the High Court.

### 260.140 Stay of proceedings for similar cases [TAA, s 138R]

The CIR may stay proceedings by issuing a notice advising a disputant that a challenge is to be stayed because a test case on a similar challenge or objection is to be heard by the High Court. The CIR may issue a notice staying proceedings only if:

(a) The CIR considers that the test case is likely to be determinative of all or a substantial number of the issues in the challenge proposed to be stayed; and

(b) The challenge proposed to be stayed has not been determined by the TRA or the High Court.

When a disputant receives a notice staying proceedings, the disputant may issue a notice requiring that there be no stay of proceedings and notifying the CIR that the disputant requires the challenge to be heard even though a test case is pending. Within 14 days after the CIR receives a notice requiring that there be no stay of proceedings, the CIR may apply to the High Court for an order that the challenge be stayed pending the determination of the test case or the further order of the Court.

If a challenge is stayed, the disputant or the CIR may apply to the High Court for an order that the challenge cease to be stayed.

A stay, following issue of a notice by the CIR, lapses on the expiry of 14 days following the day on which any of the following occurs:

(a) The expiry of the 14 day period, if the disputant has issued a notice requiring there to be no stay of proceedings and the CIR has not, within the 14 day period, made an application to the High Court for an order that the challenge be stayed;

(b) The making by the High Court of an order dismissing the CIR’s application;
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(c) The making by the High Court, on an application by the disputant or the CIR, of an order that the challenge cease to be stayed; or

(d) The determination of the test case which caused the challenge to be stayed by the expiration of all rights of appeal.

During the period a challenge is stayed:

(a) Any time limits or periods specified in or under the TAA (other than s 138R), in relation to the challenge are not to apply; and

(b) Where the stay of a challenge lapses, any time limits or periods so specified are to be treated as if they were extended by the period of the stay.

The CIR may give notices in relation to stays of proceedings:

(a) Personally;

(b) By sending a copy of the notice to the disputant by registered post to the disputant’s usual or last known place of abode or business in New Zealand, in which case it shall be deemed to have been received when in the ordinary course of post it would be delivered;

(c) By service on a solicitor who accepts service in writing on behalf of the disputant. The service shall be deemed to be personal service on the disputant; or

(d) By effective delivery to an address for service supplied by the disputant to the CIR.

260.145 Challenge to be heard by TRA [TAA, s 138S]

A challenge to a disputable decision made by the CIR under:

(a) The Student Loan Scheme Act 1992, or any provision of the TAA that applies in relation to an employer’s obligation under the Student Loan Scheme Act 1992;

(b) The Child Support Act 1991, or any provision of the TAA that applies in relation to an employer’s obligation under the Child Support Act 1991; and

(c) Any other tax law, where that tax law or another tax law specifies that the disputable decision is to be determined by the TRA,

is to be commenced, heard, and finally determined by the TRA. Section 138S overrides any other section in Part 8A of the TAA.

Note: The Student Loan Scheme Act 1992 is replaced by the Student Loan Scheme Act 2011 from 1 April 2012.

260.150 Taxation Review Authorities [TRAA, ss 5, 6, 13, 13A, 13B, 16, 17, 22, 22B, 23]

The function of a Taxation Review Authority (“TRA”, also referred to as an “Authority”) is to sit as a judicial authority for hearing and determining objections and challenges to assessments of tax and to other decisions or determinations of the CIR as authorised by the Inland Revenue Acts [TRAA, s 13]. The TRA has:

(a) A general jurisdiction to hear and determine objections and challenges, as authorised by the TRAA 1994 and the TAA 1994 [TRAA, s 13A].

(b) For disputes or challenges in relation to which there was an election into the small claims jurisdiction before 29 August 2011, the TRA also had a small claims jurisdiction to determine challenges where the facts were clear and not in dispute, the tax to pay or tax effect was less than $30,000 ($15,000 before 1 April 2005), and there were no significant legal issues of precedent [TRAA, s 13B].

“Tax effect” means the value of an adjustment or amendment to an assessment calculated by applying the taxpayer’s marginal rate of tax for the relevant return period [TRAA, s 13B(2)].

The TRA consists of either a District Court Judge or a barrister or solicitor of the High Court of not less than seven years’ practice. The TRA is appointed by the Governor-General on the recommendation of the Minister of Justice for a term of up to seven years, and may be reappointed. A TRA can be suspended or removed.
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from office for taking on a job for reward outside the duties of the office or for disability, bankruptcy, neglect of duty, or misconduct, and may also resign. When the term of office expires, or on resignation, the TRA continues in office until all outstanding matters are finalised [TRAA, ss 5, 6].

The TRA has all the powers, duties, functions, and discretion of the CIR in making the determination [TRAA, s 16]. The TRA may receive as evidence any statement, document, information, or matter that may assist it to deal effectually with the proceedings, whether or not it would be otherwise admissible in a Court of law [TRAA, s 17(1)].

If the CIR issues a disclosure notice to a disputant and the disputant challenges the disputable decision, the CIR and the disputant can raise in the challenge only the issues and the propositions of law, disclosed in the CIR’s and the disputant’s statements of position [TRAA, s 17(2A)]. The TRA may allow either party, on application, to raise in the challenge new propositions of law, and new issues, if satisfied that the applicant could not, with due diligence, have discerned those propositions of law or issues at the time of delivery of the applicant’s statement of position, and the TRA considers such admission is necessary to avoid manifest injustice [TRAA, s 17(2B)].

The hearing of an objection or challenge before the TRA is not to be open to the public [TRAA, s 16(4)]. Where an objection is withdrawn, whether by reason of settlement prior to hearing or merely because the taxpayer abandons it, that is the end of the matter so far as the TRA is concerned: TRA Case H7 (1986) 8 NZTC 153. Costs may be awarded to or against the objector or the CIR [TRAA, s 22]. If the objector or the disputant dies, the proceedings before the TRA continue with the legal representative substituting for the deceased [TRAA, s 23].

From 1 April 2008, the TRA may award costs, up to the amount of the filing fee, to the objector or disputant [TRAA, s 22B].

In Holdaway v Commissioner of Inland Revenue (1986) 8 NZTC 5,073 (HC), the High Court stated that there is good reason in tax cases for adopting an approach which is somewhat different from that in ordinary civil litigation when considering awards of costs. A right of objection to an income tax assessment was important and care must be exercised to ensure that the likelihood of an award of costs did not unduly inhibit the exercise of that right.

The TRA has authority in limited circumstances to recover its costs in objection or challenge proceedings, but does not have authority to recover costs for the CIR: TRA Case R26 (1994) 16 NZTC 6,147, (1994) 18 TRNZ 958.

The TRA does not have the power to conduct a judicial review of the process by which the CIR arrives at an assessment. Such a review can only be conducted by the High Court: TRA Case S59 (1996) 17 NZTC 7,378.

260.155 TRA directions hearing [TRA Regulations 1998, regs 26, 27, 28, 29, 30, 32, 34]

Before the TRA hears a case, it must hold a directions hearing. At this hearing it may do all or any of the following things:

(a) Obtain estimates of the time for the duration of the challenge;

(b) Make any appropriate direction concerning the way in which the evidence is to be given at the challenge;

(c) Make any appropriate direction concerning a fact, evidence, issue or proposition of law that is not included in the CIR’s or the disputant’s statement of position, but that the CIR or disputant wishes to raise in the challenge;

(d) Define the issues to be determined;

(e) Make any appropriate direction arising from any interlocutory applications;

(f) Make any appropriate direction appearing to promote the resolution of the proceedings in a just, expeditious and economical way;
(g) Fix a hearing date, if appropriate [TRA Regulations 1998, reg 29].
An authorised Inland Revenue officer and the disputant must both attend the directions hearing. The TRA may permit a disputant (or their representative) to attend the directions hearing by way of a telephone conference linkup. If the disputant does not attend this hearing, the challenge is deemed to be withdrawn unless the TRA gives leave to continue with it [TRA Regulations 1998, regs 30, 32].

After the directions hearing, either the disputant or the CIR can apply to the TRA to appoint a time for the challenge to be heard [TRA Regulations 1998, reg 34]. These procedures enable both the CIR and the disputant to perhaps settle differences before a hearing.

260.160 Disputant should be present at TRA hearing
The TRA may dispense with accepted rules of evidence to deal effectively with the case in hand. However, the TRA is a legal forum and rules of evidence and procedure must generally be adhered to by advocates and professional advisers. The TRA may dismiss a challenge made by a taxpayer where there has been a failure by that taxpayer to attend any hearing of the challenge.

The disputant and the CIR are entitled to appear personally or be represented by counsel, solicitor, or an agent. TRA Case D10 (1979) 4 NZTC 60,480, (1979) 3 TRNZ 252 demonstrates the desirability of the objector being present at the hearing of the case, where his or her credibility can be vital to the outcome. The objector, who was a builder, bought land in 1970 for the purpose of erecting buildings. The agreement for sale and purchase and the certificate of title were in the objector’s sole name. In 1974 he transferred one-half share in the land to his wife. The CIR treated the transfer of the one-half share as a sale and assessed the objector on the profit. The objector claimed that he had held the half-share in trust for his wife from the date of purchase in 1970. The TRA confirmed the CIR’s assessment on the ground that there was no evidence to support the claim that the objector had made an oral declaration in favour of his wife at the time of the purchase. The objector chose not to be present at the hearing or be represented. The TRA pointed out that the evidence on oath of the objector was vital to the success of the case as a question of credibility was involved.

In TRA Case E86 (1982) 5 NZTC 59,499, the need for the objector and his professional advisers to be present at the case stated hearing was emphasised. The objectors did not appear in person before the case stated hearing and the TRA confirmed the assessments. The taxpayer requested a rehearing of the case which was granted by the TRA.

In TRA Case L49 (1989) 11 NZTC 1,291, (1989) 13 TRNZ 49, the CIR’s assessments were held correct in the absence of the taxpayer at hearing, the taxpayer having failed to prove on the balance of probabilities that the assessments were wrong or by how much they were wrong.

In TRA Case L50 (1989) 11 NZTC 1,292, (1989) 13 TRNZ 75, an adjournment was granted where the taxpayer was overseas, although it was acknowledged that fact is not per se a reason for adjournment.

260.165 Burden of proof
In all cases, except where the assessment is for penal tax, the onus of proving that the assessment is wrong rests with the taxpayer. Once the CIR has issued the notice of assessment or determination it is binding in law unless the challenge process has been followed. Taxpayers must show not only that the CIR’s assessment is wrong but also by how much it is wrong: TRA Case H12 (1986) 8 NZTC 168, (1986) 9 TRNZ 292.

In TRA Case L50 (1989) 11 NZTC 1,292, (1989) 13 TRNZ 75, Bathgate J commented on the course of the proceedings and stressed that, in the majority of case stated proceedings, the burden of proof is on the objector (disputant). It is for the objector to prove sufficient facts to establish at least the basic and relevant evidence of the case and the evidence the objector has to give in order to succeed. The case stated request normally sets out the issue to be determined and events leading up to it. It is not proof or evidence of the relevant facts for determination of that issue. It is for the objector to prove, normally by oral evidence given on oath at the hearing, the essential facts for a determination to be made, otherwise there is a substantial risk that a determination is made on the ground that the objector has not discharged the burden of proof.
If the onus cannot be satisfied by proof of an exact amount, the taxpayer must then show on the balance of probabilities that his or her estimate is preferable to that of the CIR: *Dunnenberger v Commissioner of Inland Revenue* (1982) 5 NZTC 61,299, (1982) 5 TRNZ 835 (HC). See also *Yew v Commissioner of Inland Revenue* (1984) 6 NZTC 61,710 (CA).

In *TRA Case F129* (1984) 6 NZTC 60,191, (1984) 8 TRNZ 83, it was held that on the basis of the evidence penal tax was not chargeable to the objector. The objector did not file returns for the 1978 to 1980 income years. The CIR investigated the affairs and issued assessments for the three years. There was no objection to the assessment. The CIR then assessed penal tax and the taxpayer objected. The taxpayer submitted that there was no intention or attempt to evade payment of tax, but merely a failure to maintain records of expenditure.

In *TRA Case K8* (1988) 10 NZTC 149, a company’s claim for deduction of legal costs was denied. The legal advice was to the benefit of the company and its sole shareholder and director. No basis of apportionment of the benefit of expenditure was shown and it failed to show by how much the CIR’s assessment was incorrect.

In *TRA Case M119* (1990) 12 NZTC 2,760, (1990) 15 TRNZ 273, in the absence of records regarding a shareholder’s current account the assessments were not shown to be wrong or by how much they were wrong and the assessments of deemed dividends were upheld.

In *TRA Case G4* (1985) 7 NZTC 1,009, a taxpayer claimed a deduction for expenses but did not appear at the hearing to give evidence in support of the claim. It was held that the burden of proof is placed on the taxpayer and, as insufficient evidence had been received to discharge this burden, the assessments were confirmed. A similar result was realised for the same reason in *TRA Case J21* (1987) 9 NZTC 1,120 (1986) 10 TRNZ 382.

**260.170 Enlarging the grounds of an assessment**

The grounds of an assessment impose a limitation on the CIR’s future action and are, therefore, crucially important. In certain circumstances the CIR can change the grounds of assessment but in general terms they impose the same limits on the CIR that the grounds of objection or challenge later impose on the taxpayer.

It is in the interests of the taxpayer to have the grounds very narrowly stated. There is no statutory requirement that the taxpayer be informed of the grounds of the assessment. However, if the CIR does not disclose the grounds it is difficult for the taxpayer to form a challenge or objection. There is a general argument based on equity that the taxpayer should be informed of the grounds. This receives further support from the related notion that the CIR must have a basis for an assessment. An assessment cannot be produced out of thin air: *Tierney v Commissioner of Inland Revenue* (1982) 5 NZTC 61,112, (1982) 5 TRNZ 271 (HC), *TRA Case T49* (1998) 18 NZTC 8,335 and *TRA Case T22* (1997) 18 NZTC 8,124.

The CIR may find it necessary to change the grounds of an assessment where the original grounds were too narrow or where the original assessment was on the wrong basis. This is generally avoided by assessing on the broadest grounds possible.

There are three principles governing the alteration of the grounds of assessment:

(a) The CIR is the statutory agent of the Crown: *Cates v Commissioner of Inland Revenue* (1982) 5 TRNZ 603 (CA).

(b) Tax is imposed by legislation and the CIR merely acts to quantify the amount due: *Rickett & Colman New Zealand Ltd v Taxation Board of Review* [1966] NZLR 1032 (CA). The quantification may require the CIR to exercise judgment: *Lemming Holdings Ltd v Commissioner of Inland Revenue* [1984] 2 NZLR 214, (1983) 6 NZTC 61,576 (HC). However, the CIR cannot choose to forego enforcing the Act merely because the initial assessment was wrong.

(c) The CIR has a duty to act equitably, which means that the taxpayer must have the chance to object or challenge the entire assessment. Having objected, the taxpayer must have the opportunity to argue every point of the objection before the TRA or High Court.

The practical effects of the three principles are that the CIR can enlarge or change the grounds of the assessment, and the taxpayer must be given the chance to object to or challenge any such changes or enlargements, and be able to argue the case before the TRA or High Court.
Disputes and Challenges Procedures

260.175 CIR’s approach to disputes and challenges

There are two mechanisms by which the CIR can alter an assessment: either by reassessment or by altered assessment.

Where the CIR is merely amplifying existing grounds or advancing new contentions to support the provisions or principles already relied on, it is neither an amended assessment nor a reassessment. An altered assessment arises where either:

(a) A challenge or objection right is still “live”; or
(b) A “fresh” or “increased” income tax liability has arisen.

A detailed explanation of the disputes resolution and challenges procedures and of how Inland Revenue administers these procedures is set out in TIB vol 8:3 (August 1996). The CIR has incorporated into the disputes procedures new administrative (non-legislative) procedures. The conference process is intended to help ensure that issues are resolved during the dispute process. A conference may occur at any stage during the dispute. The Adjudication Unit is a separate unit within Inland Revenue whose function is to independently review disputes. According to the TIB, adjudication “brings an impartial fresh perspective to the dispute”.

The CIR has no legal obligation to undertake administrative procedures that are internal processes of Inland Revenue and are not provided for in legislation: Commissioner of Inland Revenue v ANZ National Bank Ltd (2007) 23 NZTC 21,167 (CA).

260.180 Conferences

The following is Inland Revenue’s explanation in TIB vol 8:3 (August 1996) of how conferences will be used in relation to disputes resolution.

(1) Purpose

The purpose of a conference is to:

(a) Identify and clarify the facts or issues in dispute;
(b) Facilitate resolution of any disputed facts;
(c) Facilitate resolution of any disputed issues; and
(d) State the facts and define the issues in a clear and concise manner for consideration by the Adjudication Unit if they cannot be resolved.

The conference phase is an administrative practice of the CIR. It is not mandatory to have a conference. It is the CIR’s responsibility to ensure that the disputes process moves to the conference stage as required.

(2) Conduct of a conference

Conferences will be kept as flexible as possible, consistent with the taxpayer’s wishes and other factors such as the scope of the audit. Conferences may range from a phone call to several meetings, both before and after the disclosure stage. For complex cases, discussions or conferences are likely to be more formal. If necessary the conference may adhere to a set agenda with one or more face-to-face meetings. The meetings may involve not only the taxpayer and the Inland Revenue officers dealing with the matter, but also lawyers and other appropriate Inland Revenue officers, accountants and lawyers representing the taxpayer, and, if necessary, other experts advising either party. The experts will be people such as valuers, academics, engineers, or bankers, who can provide specialist advice.

(3) Legal and other advisers attending a conference

If a dispute is not settled during the audit or notice of proposed adjustment (NOPA) stage, both the CIR and the taxpayer may want to obtain further expert legal or technical advice. The CIR accepts that in these circumstances it is appropriate for a certain amount of “back tracking” to take place. Some items that have already been discussed between the parties may need to be revisited by the newly-introduced advisers. This approach is consistent with the overall objective of the new procedures, which is to ensure a correct assessment. If this were not the case, it would put pressure on the parties in many disputes to involve expert advisers at an earlier stage than is actually required.
It is not possible to revisit items that have previously been agreed in writing or have not been rejected within the applicable response period.

(4)  Conference not held or abridged

The CIR considers the conference phase to be a vital part of the disputes resolution process. Only in rare circumstances will the CIR not hold a conference, or decide to end or abridge a conference that is already in progress. The CIR will not prolong the conference phase, even if agreement has not been reached.

The conference may be abridged or dispensed with if any of the following apply:

(a)  The CIR is satisfied that the taxpayer or the taxpayer’s agent is acting in a frivolous or vexatious manner, such as when the taxpayer or agent is setting unreasonable demands as to the time and place or terms of such meeting or refusing to conduct themselves reasonably at any meeting;

(b)  Revenue losses may result from delaying tactics on the part of the taxpayer; or

(c)  The taxpayer or agent and the CIR agree to disagree.

Any decision to dispense with or abridge the conference process will be made by an appropriate officer. The decision will be communicated in writing to the taxpayer or agent within five working days of when it is made. A decision to dispense with or abridge the conference process may be changed at the discretion of the reporting officer.

If issues remain unresolved after a conference, the CIR will invoke the disclosure procedures. After the disclosure phase, a further conference may be held if it is likely to help resolve the dispute.

260.185  Adjudication

The following is Inland Revenue’s explanation in TIB vol 8:3 (August 1996) of how Inland Revenue’s Adjudication Unit will be used in relation to disputes resolution.

(1)  Function of the Adjudication Unit

If agreement has not been reached on all issues at the end of the conference/disclosure stage, the case will generally be sent to the Adjudication Unit for consideration, regardless of the issue or amount of tax involved. The Adjudicator is an impartial officer within Inland Revenue, independent of the audit functions. The Adjudicator is required to take a fresh look at the application of the law to the facts of the case.

(2)  Documents to be sent to the Adjudication Unit

On completion of the pre-adjudication disputes resolution process, the following documents will be sent to the Adjudication Unit:

(a)  Notice of proposed adjustment.
(b)  Response notice.
(c)  Rejection of the CIR’s response notice (if applicable).
(d)  Notes of conferences.
(e)  The taxpayer’s statement of position.
(f)  The CIR’s statement of position.
(g)  Any relevant documentary evidence.

A cover sheet will be attached giving details of the taxpayer’s (or taxpayer’s agent’s) and investigator’s names and addresses and the documents attached. A copy of the cover sheet will be sent to the taxpayer or agent together with a letter asking if they would like any other material already disclosed to be sent to the Adjudication Unit. Taxpayers can request copies of any documents they do not already have, such as notes of conferences. Taxpayers will be given 10 working days to respond, after which the file will be sent to the Adjudication Unit.
(3) **Limited fact-finding**

The Adjudicator may need to contact a party involved in the dispute, in order to clarify a point. However, this should be extremely rare.

If the Adjudicator contacts either party, the contact will be recorded in writing. The reason for the contact will be noted, and the other party will be notified as follows:

(a) If contact is to be made with the investigator or other officer, an internal memo will be written to the investigator outlining the reason for the contact. The taxpayer or agent will receive a copy of the memo.

(b) If contact is to be made with the taxpayer or agent, a letter will be written to the taxpayer or agent outlining the reason for the contact. The investigator or other officer will receive a copy of the letter.

If there is a written response from either party, the Adjudicator will forward a copy to the other party. If the Adjudicator requests a meeting, the other party to the dispute will have an opportunity to attend that meeting. The process adopted by Adjudication Unit for dealing with communications with the parties to a dispute are set out in TIB vol 15:12 (December 2003) at 62-63.

(4) **Time-frames**

The Adjudication Unit will attempt to determine the outcome of a case within four to six weeks, subject to workloads and the complexity of cases. Complex cases may take longer than four to six weeks to complete. The time-frame within which decisions are anticipated to be made will be periodically reviewed.

(5) **What happens if a key argument is missed**

On rare occasions the Adjudicator may believe that the assessment will be materially incorrect if he or she accepts either line of argument, because some important legal issue has been missed by both parties or has not been pursued. In these circumstances, the Adjudicator will refer the case back to the investigator or other officer for rework. Another conference may need to be held or a new NOPA may need to be issued. The Adjudication Unit will prepare a “reference back” letter to the taxpayer or agent advising that the file has been referred back to the investigator or other officer. This letter will state the reasons why the file has been referred back.

For cases referred back for rework, the procedure to refer the case back to Adjudication will start at the disclosure notice phase, as the earlier statement of position may no longer be valid for the issues referred back. In some instances the taxpayer and the CIR may agree to amend their statements of position, having regard to the reasons for the case being referred back to the investigator.

These procedures are intended to meet the objective of issuing correct assessments first time.

(6) **Adjudicator’s decision**

In all cases a copy of the Adjudicator’s decision will be sent to the taxpayer or the taxpayer’s agent and the Inland Revenue investigator or other officer involved with the case.

If the Adjudicator determines all the issues in favour of the taxpayer:

(a) If the CIR issued the NOPA, the query will be at an end. If any issues were agreed to before the case was referred to adjudication and an assessment is required, the Adjudication Unit will issue the assessment.

(b) If the taxpayer issued the NOPA, any assessment action will be undertaken by the Adjudication Unit, taking into account any issues agreed on before the case was referred to adjudication.

If the Adjudicator agrees with the adjustments proposed by the CIR, the Adjudication Unit will issue an assessment on that basis. If the Adjudicator agrees with the CIR’s position not to accept a taxpayer’s proposed adjustment, he or she will issue a disputable decision. Any challenge to that assessment or disputable decision [see 260.70], must be filed in the appropriate hearing authority within two months of the date of issue of the assessment or disputable decision.
If the Adjudicator agrees in part with the taxpayer and in part with the CIR, the Adjudication Unit will issue any assessment required to be made. When the Adjudicator determines an issue or adjustment in favour of the taxpayer, the investigator has no ability to challenge that decision.

The High Court in Marshall v Commissioner of Inland Revenue (2008) 23 NZTC 21,876 (HC) held that adjudication reports are assessments and can be accepted as evidence (even if they are photocopies). The manager of the Adjudication Unit has delegated power under s 7 of the TAA to make default or amended assessments of income tax and GST.

(7) Performance of Adjudication Unit

The following table summarises the outcomes of adjudications completed by the Adjudications Unit of Inland Revenue from 1997 to 2005. The figures show that only 19 per cent of adjudications were decided in favour of the taxpayer.

<table>
<thead>
<tr>
<th>Year to 30 June</th>
<th>Adjudications completed</th>
<th>Decided in favour of taxpayer</th>
<th>Decided in favour of CIR</th>
<th>Split decision</th>
<th>Returned for further Inland Revenue action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1998</td>
<td>16</td>
<td>0</td>
<td>14</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>1999</td>
<td>46</td>
<td>6</td>
<td>28</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>2000</td>
<td>55</td>
<td>7</td>
<td>37</td>
<td>9</td>
<td>2</td>
</tr>
<tr>
<td>2001</td>
<td>70</td>
<td>22</td>
<td>36</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>2002</td>
<td>63</td>
<td>9</td>
<td>49</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>2003</td>
<td>63</td>
<td>18</td>
<td>33</td>
<td>11</td>
<td>1</td>
</tr>
<tr>
<td>2004</td>
<td>67</td>
<td>9</td>
<td>50</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>2005</td>
<td>20</td>
<td>5</td>
<td>12</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>401</td>
<td>77</td>
<td>259</td>
<td>44</td>
<td>21</td>
</tr>
<tr>
<td></td>
<td>100%</td>
<td>19%</td>
<td>65%</td>
<td>11%</td>
<td>5%</td>
</tr>
</tbody>
</table>


260.190 Disputes resolution process

(1) Disputes resolution process commenced by the CIR

Standard practice statement SPS 11/05: Disputes resolution process commenced by the CIR [see TIB vol 23:9 (November 2011) at 16–49] outlines the CIR’s rights and responsibilities with a taxpayer in respect of an adjustment to an assessment when the CIR commences the disputes resolution process. It applies from 13 October 2011.

The following table summarises the key actions and administrative time-frames when the disputes resolution process is commenced by the CIR.

<table>
<thead>
<tr>
<th>Key actions</th>
<th>Indicative time-frames</th>
</tr>
</thead>
<tbody>
<tr>
<td>The CIR’s NOPA</td>
<td></td>
</tr>
<tr>
<td>The CIR will advise the taxpayer that a NOPA will be issued.</td>
<td>Usually within five working days before the date that the CIR issues a NOPA, but this may happen earlier.</td>
</tr>
<tr>
<td>The CIR will confirm whether the taxpayer has received the CIR’s NOPA (either by telephone or in writing).</td>
<td>Within 10 working days from the date that the CIR’s NOPA is issued, where practicable.</td>
</tr>
</tbody>
</table>
Key actions

Taxpayer’s NOR

The taxpayer issues a NOR in response to the CIR’s NOPA within the applicable response period.

The CIR will confirm whether the taxpayer will issue a NOR.

The CIR will forward the taxpayer’s NOR to the responsible officer.

The CIR will acknowledge the receipt of the taxpayer’s NOR.

The CIR will advise that the taxpayer’s NOR is deficient, but the two-month response period has not expired.

The CIR will consider the application of s 89K, where a taxpayer’s NOR has been issued outside the applicable response period.

The taxpayer is deemed to accept the CIR’s NOPA, because they failed to issue a NOR within the applicable response period and s 89K does not apply in the case of a late NOR.

The CIR will advise the taxpayer in writing that they are deemed to accept the CIR’s NOPA.

The CIR will advise the taxpayer whether their NOR is being considered, has been accepted or rejected in full or part.

If the taxpayer’s NOR has been accepted in full, the dispute finishes and Inland Revenue will take appropriate actions (for example, issue an amended assessment).

Conference phase

The CIR will write to the taxpayer to initiate the conference phase and offer a facilitated conference.

The taxpayer will advise Inland Revenue whether they will attend the conference meeting, and whether they will accept the conference facilitation offer.

When a taxpayer agrees to attend a conference meeting, Inland Revenue will contact the taxpayer to establish a time-frame, and agree on how the meeting will be conducted.

Indicative time-frames

Within two months from the date that the CIR’s NOPA is issued, unless any of the “exceptional circumstances” under s 89K applies.

Usually two weeks before the response period for the CIR’s NOPA expires.

Usually within five working days after the taxpayer’s NOR is received.

Usually within 10 working days after the taxpayer’s NOR is received.

Inland Revenue officers will advise the taxpayer or their agent immediately after they become aware of the deficiency.

The CIR will advise the taxpayer of the outcome within one month of receipt of the disputant’s “late” notice. If the application is rejected, a refusal notice will be issued.

At the end of the two-month period starting on the date of issue of the CIR’s NOPA.

Usually two weeks after the response period to the CIR’s NOPA has expired.

Usually within one month after the taxpayer’s NOR is received.

Usually within one month after the advice of acceptance of the NOR is issued.

The CIR’s offer of a facilitated conference will be made in writing within one month from the date of issue of the taxpayer’s NOR.

The conference letter marks the start of the conference phase.

Usually within two weeks of receipt of the conference facilitation letter. If the taxpayer does not respond within this time-frame, the Inland Revenue officers involved in the dispute will contact the taxpayer about the letter.

Usually within two weeks following the taxpayer’s agreement to a conference.
### Disputes and Challenges Procedures

**Key actions**

Conference meeting(s) and further information exchange between Inland Revenue and the taxpayer.

**Indicative time-frames**

The suggested average time-frame of the conference phase is three months, subject to the facts and complexity of the dispute.

**Opt out**

The taxpayer may request to opt out of the disputes resolution process.

The suggested average time-frame of the conference phase is three months, subject to the facts and complexity of the dispute.

**Disclosure notice and the CIR’s SOP**

The CIR will advise the taxpayer that a disclosure notice and the CIR’s SOP will be issued.

Usually within two weeks before the date that the CIR’s disclosure notice and SOP are issued.

**Taxpayer’s SOP**

The taxpayer must issue a SOP within the response period for the disclosure notice.

Within two months after the date that the disclosure notice is issued, unless any of the “exceptional circumstances” under s 89K apply.

**Addendum to the CIR’s SOP**

The CIR can provide additional information via an addendum to the CIR’s SOP under s 89M of the response period for the taxpayer’s SOP.

Within two months after the taxpayer’s SOP is issued.

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### Key actions

- Conference meeting(s) and further information exchange between Inland Revenue and the taxpayer.

### Indicative time-frames

- The suggested average time-frame of the conference phase is three months, subject to the facts and complexity of the dispute.

### Opt out

- The taxpayer may request to opt out of the disputes resolution process.

### Disclosure notice and the CIR’s SOP

- The CIR will advise the taxpayer that a disclosure notice and the CIR’s SOP will be issued.

### Taxpayer’s SOP

- The taxpayer must issue a SOP within the response period for the disclosure notice.

### Addendum to the CIR’s SOP

- The CIR can provide additional information via an addendum to the CIR’s SOP under s 89M of the response period for the taxpayer’s SOP.
### Disputes and Challenges Procedures

**Key actions**  
The CIR will consider the taxpayer’s request to include additional information in their SOP under s 89M(13).  

**Indicative time-frames**  
Usually within one month after the date that the CIR’s addendum is issued.

#### Adjudication

The CIR will prepare a cover sheet and issue a letter (including a copy of the cover sheet) to the taxpayer to seek their concurrence of the materials to be sent to the adjudicator.

**Key actions**  
The taxpayer must respond to the CIR’s letter.

**Indicative time-frames**  
Within 10 working days after the date that the CIR’s letter is issued.

The CIR will forward materials relevant to the dispute to the Adjudication Unit.

**Key actions**  
The taxpayer must respond to the CIR’s letter.

**Indicative time-frames**  
Usually after the taxpayer has concurred on the materials to be sent to the Adjudication Unit or after 10 working days allowed for the taxpayer’s response to have elapsed if no response is received.

#### Adjudication of the disputes case.

**Key actions**  
The CIR will forward materials relevant to the dispute to the Adjudication Unit.

**Indicative time-frames**  
Usually within three months after the date that the Adjudication Unit receives the dispute files depending on the number of disputes that are before the Adjudication Unit, any allocation delays and the technical, legal and factual complexity of those disputes.

(2) **Disputes resolution process commenced by a taxpayer**

Standard practice statement SPS 11/06: Disputes resolution process commenced by a taxpayer [see TIB vol 23:9 (November 2011) at 50–78] outlines the taxpayer’s rights and responsibilities in respect of an assessment or other disputable decision when a taxpayer commences the disputes resolution process. It applies from 13 October 2011.

The following table summarises the key actions and administrative time-frames when the disputes resolution process is commenced by the CIR.

<table>
<thead>
<tr>
<th><strong>Key actions</strong></th>
<th><strong>Indicative time-frames</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>The CIR’s NOPA</td>
<td>A taxpayer’s response period for issuing a NOPA in respect of an assessment or other disputable decision.</td>
</tr>
<tr>
<td>The CIR forwards and assigns the taxpayer’s NOPA to the responsible officer.</td>
<td>Usually within five working days after the taxpayer’s NOPA is received.</td>
</tr>
<tr>
<td>The CIR acknowledges the receipt of the taxpayer’s NOPA (either by telephone or in writing).</td>
<td>Usually within 10 working days after the taxpayer’s NOPA is received.</td>
</tr>
<tr>
<td>The CIR advises that the taxpayer’s NOPA is deficient, but the applicable response period has not expired.</td>
<td>Immediately after the Inland Revenue officer becomes aware of the deficiency.</td>
</tr>
<tr>
<td>The CIR considers the application of s 89K, where a taxpayer’s NOPA has been issued outside the applicable response period.</td>
<td>The CIR will advise the taxpayer of the outcome within one month of receipt of the disputant’s “late” notice. If the application is rejected, a refusal notice will be issued.</td>
</tr>
</tbody>
</table>

**The CIR’s NOR**

The CIR advises the taxpayer (either by telephone or in writing) whether the CIR intends to issue a NOR.

**Key actions**  
The CIR advises the taxpayer (either by telephone or in writing) whether the CIR intends to issue a NOR.

**Indicative time-frames**  
Usually within 10 working days before the response period for the taxpayer to issue a NOPA expires.
Disputes and Challenges Procedures

**Key actions**

The CIR has issued and the taxpayer has received a NOR.

The taxpayer’s written rejection of the CIR’s NOR

The CIR confirms whether the taxpayer will reject the CIR’s NOR.

The taxpayer rejects the CIR’s NOR in writing.

Inland Revenue forwards the taxpayer’s rejection of the CIR’s NOR to the responsible officer.

The CIR acknowledges receipt of the taxpayer’s rejection of the CIR’s NOR.

The taxpayer is deemed to accept the CIR’s NOR, because they have failed to reject it within the applicable response period and none of the reasons in s 89K apply.

The CIR will advise the taxpayer in writing that they are deemed to accept the CIR’s NOR.

Conference phase

The CIR will write to the taxpayer to initiate the conference phase and offer a facilitated conference.

The taxpayer will advise Inland Revenue whether they will attend the conference meeting, and whether they will accept the conference facilitation offer.

When a taxpayer agrees to attend a conference meeting, Inland Revenue will contact the taxpayer to establish a time-frame, and agree on how the meeting will be conducted.

Conference meeting(s) and further information exchange between Inland Revenue and the taxpayer.

Opt out

The taxpayer may request to opt out of the disputes resolution process.

An Inland Revenue officer will advise the taxpayer whether the request to opt out has been agreed to.

Disclosure notice

The CIR advises the taxpayer that a disclosure notice will be issued.

**Indicative time-frames**

Within two months starting on the date that the taxpayer’s NOPA is issued.

Usually two weeks before the response period for the CIR’s NOR expires.

Within two months after the date that the CIR’s NOR is issued.

Usually within five working days after receiving the taxpayer’s rejection.

Usually within 10 working days after receiving the taxpayer’s rejection.

At the end of the two-month period starting on the date of issue of the CIR’s NOR.

Within two weeks after the response period for the CIR’s NOR has ended.

The CIR’s offer of a facilitated conference will be made in writing within one month after the CIR receives the taxpayer’s rejection of the CIR’s NOR.

The conference letter marks the start of the conference phase.

Usually within two weeks of receipt of the conference facilitation letter. If the taxpayer does not respond within this time-frame, the Inland Revenue officers involved in the dispute will contact the taxpayer about the letter.

Usually within two weeks following the taxpayer’s agreement to a conference.

The suggested average time-frame of the conference phase is three months, subject to the facts and complexity of the dispute.

Within two weeks from the end of the conference phase.

Usually within two weeks from the date of the taxpayer’s request to opt out.

Usually within two weeks before the date that the disclosure notice is issued.
<table>
<thead>
<tr>
<th>Key actions</th>
<th>Indicative time-frames</th>
</tr>
</thead>
<tbody>
<tr>
<td>The CIR issues a disclosure notice to the taxpayer.</td>
<td>Usually within one month of the end of the conference phase.</td>
</tr>
<tr>
<td><strong>Taxpayer’s SOP</strong></td>
<td></td>
</tr>
<tr>
<td>The taxpayer must issue a SOP within the response period for the disclosure notice.</td>
<td>Within two months after the date that the disclosure notice is issued, unless s 89K applies.</td>
</tr>
<tr>
<td>The CIR confirms whether the taxpayer will issue a SOP.</td>
<td>Usually 10 working days before the response period for the disclosure notice expires.</td>
</tr>
<tr>
<td>The CIR forwards the taxpayer’s SOP to the responsible officer.</td>
<td>Usually within five working days after the taxpayer’s SOP is received.</td>
</tr>
<tr>
<td>The CIR acknowledges the receipt of the taxpayer’s SOP.</td>
<td>Usually within 10 working days after the taxpayer’s SOP is received.</td>
</tr>
<tr>
<td>The CIR advises that the taxpayer’s SOP is deficient, but the two-month response period has not expired.</td>
<td>Inland Revenue officers will advise the taxpayer or their agent as soon as they become aware of the deficiency.</td>
</tr>
<tr>
<td>The CIR considers whether under s 89K applies, where the taxpayer has issued a SOP outside the applicable response period.</td>
<td>The CIR will advise the taxpayer of the outcome within one month of receipt of the disputant’s “late” SOP. If the application is rejected, a refusal notice will be issued.</td>
</tr>
<tr>
<td>The dispute is treated as if it was never commenced, if the taxpayer fails to issue a SOP within the applicable response period and none of the s 89K grounds apply.</td>
<td>Usually 10 working days after the response period for the disclosure notice expires.</td>
</tr>
<tr>
<td><strong>The CIR’s SOP</strong></td>
<td></td>
</tr>
<tr>
<td>The CIR issues a SOP in response to the taxpayer’s SOP.</td>
<td>Within two months after the date that the taxpayer’s SOP is issued, unless an application has been made to the High Court under s 89M(10).</td>
</tr>
<tr>
<td>The CIR considers a taxpayer’s request to include additional information in the SOP</td>
<td>Usually within one month after the date that the CIR’s SOP is issued.</td>
</tr>
<tr>
<td><strong>Adjudication</strong></td>
<td></td>
</tr>
<tr>
<td>The CIR prepares a cover sheet and issues a letter (with a copy of the cover sheet) to the taxpayer to seek concurrence on the materials to be sent to the adjudicator.</td>
<td>Usually within one month after the response period for the taxpayer’s SOP expires.</td>
</tr>
<tr>
<td>The taxpayer responds to the CIR’s letter.</td>
<td>Within 10 working days after the date that the letter is issued.</td>
</tr>
<tr>
<td>The CIR forwards materials relevant to the dispute to the Adjudication Unit.</td>
<td>Usually when the CIR receives the taxpayer’s response or within 10 working days after the date that the CIR’s letter is issued.</td>
</tr>
<tr>
<td>Adjudication of the disputes case.</td>
<td>Usually within three months after the date that the Adjudication Unit receives the disputes files, depending on the number of disputes that are before the Adjudication Unit, any allocation delays and the technical, legal and factual complexity of those disputes.</td>
</tr>
</tbody>
</table>
Disputes and Challenges Procedures

**Key actions**
The taxpayer can file challenge proceedings.

**Indicative time-frames**
Within two months of the adjudication decision.
Chapter 270

Dividends

270.10 What is a dividend? [ss CD 4, CD 5]

A dividend is a transfer of value from a company to a shareholder. A transfer of value occurs where the company provides something of value to a person and nothing, or something having a lower market value, is provided to the company in return. It includes a situation where the company releases a person from an obligation to repay a debt to the company either by way of agreement or by operation of law.

It does not include the situation where the only value provided by the company is the provision of services. However, this exclusion does not apply where the company is a close company and the service is the benefit of expenditure by the company.

Even where a transfer of value has occurred, it will be a dividend only if the factor giving rise to the transaction is a shareholding in the company [see 270.15].

Special rules apply where the company is a:
(a) Qualifying company [see 270.70];
(b) Producer board [see 270.25, 270.35]; or
(c) Co-operative company [see 270.25, 270.35].

Editorial Note
At the time of publication of the Staples Tax Guide 2012, 72nd edition, the Taxation (International Investment and Remedial Matters) Bill had not been passed into law. It is anticipated that the content of this chapter will be changed following the passing of the Bill. For an overview of the changes contained in the Bill, please refer to the “Future Developments” section of this book. When enacted, these changes will also be available in the Staples Tax Guide online at www.brookersonline.co.nz. The changes will also be included in the Staples Tax Guide 2012 - Mid-Year Supplement.
When is a dividend paid?

In *TRA Case Z4* (2009) 24 NZTC 14,051, Judge Barber found that a dividend is “paid” when an unconditional dividend is declared. That is because, when an unconditional dividend is declared, it is automatically credited to the shareholder’s current account. The crediting of the current account constitutes payment of the dividend. The CIR appealed the case to the High Court where Clifford J confirmed the decision of the TRA: *Commissioner of Inland Revenue v Albany Food Warehouse Ltd* (2009) 24 NZTC 23,532 (HC).

**Shareholder capacity test** [s CD 6]

The person’s capacity as a shareholder has to be considered when deciding whether any payment or distribution from, or a transaction with, the company is a dividend.

In order for the shareholder capacity test to be met, the person receiving the benefit must:

(a) Hold shares in the company; or
(b) Be associated with a person who holds shares in the company; or

In addition, the transfer of value must be made by the company because of the fact of that shareholding.

The transfer is likely to be a dividend if the terms differ from those that the company would make with someone who was not a shareholder. However, other factors might also indicate that the amount is, or is not, received in a shareholder capacity.

**Example 1:**

Where a shareholder-employee receives a salary for work performed, the benefit is obtained in the person’s capacity as an employee, not in his or her capacity as a shareholder. It is the work that has been done that has caused the payment to be made, not the fact that the person owns shares in the company. The salary is not a dividend.

**Example 2:**

The provision of a motor vehicle to a shareholder who is not an employee would be derived in the capacity of a shareholder and would be a dividend. If the shareholder was also an employee, it would not be a dividend but would be subject to FBT imposed on the employing company.

**Example 3:**

Where a corporate shareholder receives from a company a trading discount which is available to all those who trade with the company, the benefit does not pass to the shareholder by virtue of the shareholding, and is, therefore, not derived as a dividend.

**Bonus issues** [ss CD 7, CD 8]

A bonus issue in lieu of a dividend is deemed to be a dividend. The amount of the dividend is the amount offered as an alternative to the bonus issue, less resident withholding tax.

Where a unit trust that is a foreign company makes a bonus issue under an arrangement whereby the bonus issue is made instead of money or property vesting absolutely in the unit holder, the bonus issue is a taxable bonus issue and a dividend arises for the unit holder [see 270.65].

A bonus issue that does not fall within either of the above two categories is a dividend only if, and to the extent that, the company chooses to treat it as a taxable bonus issue, and

(a) The bonus issue shares are issued fully paid from reserves of the company; or
(b) If it was a dividend, it would not be exempt income under s CW 10 (dividend within New Zealand wholly-owned group) or s CW 11 (dividend of conduit tax relief holding company).

A taxable bonus issue is a dividend for tax purposes. The company makes this choice by:

(a) Resolving when it makes the bonus issue that it be a dividend; and
(b) Resolving when it makes the bonus issue the amount that is to be treated as a dividend; and
(c) Giving notice to the CIR under s 63 of the TAA of the election and the amount.
Dividends

270.25 Shareholder-employees and directors [s CD 20]
A non-cash benefit provided by a company to a shareholder-employee is a dividend if the benefit is an “unclassified benefit” and the company chooses (under s CX 17(2)) to treat the benefit as a dividend.

An “unclassified benefit” is a benefit that would otherwise be a fringe benefit but is not any of the following:
(a) Private use of a motor vehicle;
(b) Subsidised transport;
(c) Employment related loan;
(d) Certain services provided to members of parliament;
(e) Contributions to a superannuation scheme;
(f) Contributions to a sickness, accident or death benefit fund;
(g) Contributions to a funeral trust;
(h) Contributions to life or health insurance.

An example would be the provision of free or heavily discounted goods.

A non-cash benefit provided to a “non-executive director” is a dividend if the director is also a shareholder in the company. A non-executive director is a person whose only services to the company as an employee are the formal occupation and role of director and compliance with statutory obligations.

In all other cases, a non-cash benefit provided by a company to a shareholder-employee will not be a dividend if it is a fringe benefit.

270.35 Items not a dividend — returns of capital [ss CD 22, CD 24, CD 25, CD 26, CD 27, CD 29, CD 32, CD 33, CD 34, CD 36]

(1) Amount distributed upon an off-market cancellation [s CD 22]
Where a company makes an off-market cancellation of shares, other than on liquidation of the company, special rules apply. Any amount paid to a shareholder will not be a dividend to the extent to which it does not exceed the “available subscribed capital” (ASC) per share, provided that all of the following criteria are satisfied:
(a) One of the brightline tests is satisfied (see below);
(b) The company is not an unlisted unit trust or group investment fund that has chosen the slice rule for the share; and
(c) No part of the payment is in lieu of the payment of a dividend.

The brightline tests are:
(a) The cancellation is part of a pro rata cancellation that results in a 15 per cent capital reduction;
(b) The cancellation is part of a pro rata cancellation that results in a 10 per cent capital reduction and the CIR has given notice that, in the CIR’s view, no part of the cancellation is in lieu of the payment of a dividend;
(c) The cancellation is not part of a pro rata cancellation and the shareholder suffers a 15 per cent interest reduction;
(d) The cancellation is not part of a pro rata cancellation and the company is a unit trust or group investment fund that is not quoted on the official list of a recognised exchange; or
(e) The share is a non-participating redeemable share.

If there is any transfer of value from the shareholder to the company on the cancellation of a share of the shareholder’s rights, the market value of that transfer is deemed to be zero [s CD 5].

Where an amount is derived by a person from a cancellation of shares and that amount is also income of the person under another subpart of the Act, that other income is reduced by the amount of the dividend arising
from the cancellation of the shares (net of any ICA credit). This reduction does not occur where the dividend derived from share cancellation is exempt income of the person under ss CW 9, CW 10, or CW 11 (all of which relate to dividends derived by companies).

(2) **Amount distributed upon an on-market cancellation** [s CD 24]

An amount paid by a company in acquiring its shares in an on-market cancellation is not a dividend. However, to the extent that the amount paid exceeds the ASC per share, calculated under the ordering rule [see 270.50], it is treated as a dividend for the purposes of the following provisions:

(a) Dividend recoveries by a company [s CD 29];

(b) Meaning of the word “returns” in the definition of available subscribed capital [s CD 43(2)(c), see 270.40]; or

(c) Anti-avoidance rule [s GA 1(4)].

The excess also gives rise to a debit in the company’s imputation credit account.

Upon an on-market cancellation, a dividend does not include any amount distributed to the extent that it does not exceed the ASC per share cancelled.

If there is any transfer of value from the shareholder to the company on the cancellation of a share of the shareholder’s rights, the market value of that transfer is deemed to be zero [s CD 5].

Where an amount is derived by a person from a cancellation of shares and that amount is also income of the person under another sub-part of the act, that other income is reduced by the amount of the dividend arising from the cancellation of the shares (net of any ICA credit). This reduction does not occur where the dividend derived from share cancellation is exempt income of the person under ss CW 9, CW 10, or CW 11 (all of which relate to dividends derived by companies).

(3) **Treasury stock** [s CD 25]

The amount paid by a company for the reacquisition of any of its shares is not a dividend where both of the following criteria are met:

(a) The acquisition is deemed, under s 67A(1) of the Companies Act 1993 or under s 24 of the Co-operative Companies Act 1996, not to result in the cancellation of the share; and

(b) The acquisition is not part of a pro rata cancellation or an event which is in substance a pro rata cancellation.

Instead, where the above criteria are met, and either:

(a) The company cancels the share before the first anniversary of the acquisition;

(b) At the first anniversary, the company (not being a company that is established under New Zealand co-operative company legislation) has failed to transfer a share of the same class in an “arm’s-length transfer” (see below); or

(c) The company is established under New Zealand co-operative company legislation and cancels the share after the first anniversary.

Then:

(a) With effect from that cancellation or first anniversary (whichever comes first), the ASC of that class of share is reduced by the lesser of:

(i) The amount paid to the shareholder on the acquisition; or

(ii) The ASC per share calculated under the ordering rule as at the date of the cancellation or first anniversary. In the case of the first anniversary, the reduction is calculated as if all shares to which this rule applies were cancelled on that date; and

(b) With effect from the date of acquisition by the company, s OB 42 (debits arising to the ICA account) applies as if the acquisition were an on-market acquisition but item “ASC per share excess” of the formula in s OB 42 were equal to the excess of the amount received by the shareholder from the
acquisition over the amount of the reduction in available subscribed capital referred to in para (a) above. No imputation penalty tax is imposed which would not have arisen had this paragraph applied only with effect from the date of cancellation or the first anniversary as appropriate.

In order for the transfer of a share to be an arm’s-length transfer, at least one of following conditions must be met:

(a) The transfer is to a person not associated with the company; or
(b) The transaction that occurs on a recognised exchange, through a broker or some other agent independent of the company, and it is not preceded by any arrangement between the transferee and the company for the transfer.

(4) Amount distributed on the liquidation or emigration of the company [s CD 26]

On the liquidation of a company, or where the company migrates and is deemed under s FL 2 to have been liquidated, a dividend does not include any amount distributed for any share to the extent to which it does not exceed the aggregate of:

(a) The available subscribed capital per share cancelled under the ordering rule, and
(b) The available capital distribution amount.

(5) Intra-group property [s CD 27]

Section CD 27 contains two dividend relief provisions relating to transfers of value which arise from the making available of property for less than market value.

Under the first relief provision [s CD 27(1), (2)], where property is made available intra-group for less than market value and that transfer of value would fall within the definition of dividend because either:

(a) The company receiving the benefit is associated with a shareholder of the company providing the benefit; or
(b) The company receiving the benefit is the trustee of a trust of which a shareholder in the company providing the benefit is a beneficiary.

No dividend will arise where the following criteria are satisfied:

(a) The transfer is not a loan; and
(b) In the tax year of the company providing the benefit, the total of the transfers of value to the benefit recipient company to which this provision would apply did not exceed $10,000

Under the second relief provision [s CD 27(3), (4)], there are three companies to consider. The first is the company making the benefit available (“the first company”). The second is the company receiving the benefit (“the associated company”). The third is a company that has a voting interest in the “associated company” (“the parent company”). Under this provision, no dividend will arise where all of the following apply:

(a) The first company:
   (i) Has a voting interest in the associated company; or
   (ii) Is associated with the parent company and that parent company could have received that benefit without it being assessable income, non-resident passive income for the parent company;
(b) The associated company does not have a voting interest in the first company; and
(c) No person other than the parent company has both a voting interest (or market value interest) in the first company and a greater than 10 per cent voting interest (or market value interest) in the associated company.

The effect of this second provision is to prevent dividends from arising from downward transfers of value (downstream dividends). However, the provision does not apply where s FA 3 (Share dealing) applies.
The following examples illustrate the principle that, where a benefit passes from a company to a downstream associate, no dividend arises except where a shareholder of the company owns more than 10 per cent of the associate other than through the company.

**Example 1:**
Sub Co 2 Ltd is a wholly-owned subsidiary of Sub Co 1 Ltd, which in turn is wholly-owned by Parent Ltd. Sub Co 1 Ltd owns a 50 per cent share of Joint Venture Ltd, the other 50 per cent is owned by an unrelated person. Sub Co 1 Ltd passes a benefit to Joint Venture Ltd.

This benefit does not give rise to a dividend because the conditions in s CD 27(3) are satisfied, viz:
(a) Joint Venture Ltd being the recipient (“the associated company”) is a company;
(b) Sub Co 1 Ltd being the provider (“the first company”) has either a direct or indirect voting interest in the recipient (“the associated company”) or is associated with a company that has a voting interest in the recipient (“the parent company”);
(c) The recipient does not have a voting interest in the provider of the benefit; and
(d) No person, other than the parent company, has both an interest in the provider of the benefit and more than a 10 per cent interest in the recipient.

**Example 2:**
In the previous example a dividend does arise when Sub Co 1 Ltd passes a benefit to Joint Venture Ltd if the circumstances are such that Parent Ltd owns the other 50 per cent interest in Joint Venture Ltd. This arises because Parent Ltd holds an interest in Sub Co 1 Ltd and a direct interest of more than 10 per cent in Joint Venture Ltd.

Even though a dividend arises, it is exempt under s CW 10 because both Joint Venture Ltd and Sub Co No 1 Ltd are in the same commonly owned group. However, imputation credits are required at the benchmark rate.

Where the company providing a benefit to a corporate associate has no voting interest in the associate, but is associated with a company that has such an interest (“the parent company”), no dividend arises provided that, if the benefit had passed instead to the related party, no New Zealand tax consequences would arise.

**Example 3:**
A owns Parent Ltd which owns 100 per cent of Sub Co A Ltd and 90 per cent of Sub Co B Ltd. L holds the other 10 per cent shareholding in Sub Co B Ltd. Sub Co A Ltd and Parent Ltd are a wholly-owned group of companies. Sub Co A Ltd makes a low-interest loan to Sub Co B Ltd. Because the loan could pass from Sub Co A Ltd to Parent Ltd without triggering an assessable dividend or a FDP liability (as under s CW 10 the dividend is not assessable to Parent Ltd), no dividend arises for the loan from Sub Co A Ltd to Sub Co B Ltd.
The rationale is that, if a benefit can flow from Sub Co A Ltd to Parent Ltd without a New Zealand tax consequence (as an exempt dividend) and from Parent Ltd to Sub Co B Ltd without a tax consequence (because it is not a dividend), the benefit should be able to pass tax free directly from Sub Co A Ltd to Sub Co B Ltd.

Example 4:
Parent Ltd owns 100 per cent of Sub Co 1 Ltd, which owns 100 per cent of Sub Co 2 Ltd and 50 per cent of Joint Venture Ltd, with the remaining 50 per cent of Joint Venture Ltd being owned by an unrelated person.

A dividend does not arise when:
(a) Sub Co 2 Ltd makes a low-interest loan to Joint Venture Ltd;
(b) Parent Ltd passes a benefit to Joint Venture Ltd;
(c) Sub Co 1 Ltd makes an interest-free loan to Sub Co 2 Ltd; or
(d) Parent Ltd makes an interest-free loan to Sub Co 2 Ltd.

Example 5:
This example relates to transactions spanning across international borders. When USA Ltd owns 100 per cent of both UK Ltd and NZ Ltd, and only NZ Ltd is a resident company, the shareholders of USA Ltd have an interest in USA Ltd but (under these rules) no interest in NZ Ltd.

If USA Ltd makes an interest free loan to NZ Ltd, this does not give rise to a dividend. If UK Ltd passes a benefit to NZ Ltd this does not give rise to a dividend.
Example 6:
Parent Ltd owns 100 per cent of Sub Co X Ltd, which owns 100 per cent of Sub Co Y Ltd, which in turn owns 100 per cent of Sub Co Z Ltd.

If Sub Co Z Ltd makes an interest free loan to Sub Co X Ltd, the transaction breaches the rule where an associate (Sub Co X Ltd) holds an interest in the company providing the benefit (Sub Co Z Ltd). A dividend arises to Sub Co X Ltd to the extent of the interest foregone. The dividend is exempt to Sub Co X Ltd under s CW 10, but is subject to attaching imputation credits at the benchmark rate.

Example 7:
When Lynne owns 100 per cent of B Co Ltd and C Co Ltd and B Co Ltd disposes of property to C Co Ltd for no consideration, a dividend arises to C Co Ltd, which is exempt under s CW 10 but still subject to the imputation benchmark rules.

Example 8:
Adrian owns 100 per cent of B Ltd which owns 100 per cent of D Ltd and 80 per cent of C Ltd. Toni owns the other 20 per cent of C Ltd. When C Ltd makes an interest free loan to D Ltd, a dividend arises to D Ltd because B Ltd is a related company. If C Ltd had made an interest free loan to B Ltd, B Ltd would have received an assessable dividend equal to the interest that would have been payable on the loan had a market rate of interest been applied.
Example 9:
NZ A Ltd owns 100 per cent of UK Ltd and NZ B Ltd, but only NZ A Ltd and NZ B Ltd are New Zealand residents. If UK Ltd makes an interest free loan to NZ B Ltd for six months, it is not an attributed repatriation. NZ A Ltd is the related company, and consequently NZ B Ltd has a FDP liability as the interest shortfall is deemed a dividend.

Example 10:
UK Ltd owns 100 per cent of NZ 1 Ltd and 80 per cent of NZ 2 Ltd, but only NZ 1 Ltd and NZ 2 Ltd are New Zealand residents. Frank has a minority interest in NZ 2 Ltd.

If NZ 1 Ltd transfers property to NZ 2 Ltd for no consideration, it is a deemed dividend, because if NZ 1 Ltd had transferred the property to UK Ltd it would have given rise to a dividend which was non-resident withholding income of UK Ltd. Had NZ 2 Ltd been a wholly-owned subsidiary of UK Ltd, an exempt dividend would have arisen to NZ 2 Ltd under s CW 10.

(6) Non-taxable bonus issue [s CD 29]
A non-taxable bonus issue is not a dividend. A bonus issue is taxable only:
(a) If it is a bonus issue in lieu of dividend; or
(b) If, and to the extent to which, the company chooses that it be a taxable bonus issue.
Although a non-taxable bonus issue is not a dividend, it retains its pre-capitalisation status and is assessable as a dividend on any subsequent return to shareholders.

(7) Amounts subject to FBT [s CD 32]
A dividend does not include any amount that is subject to FBT. Therefore, benefits provided to shareholder-employees that are subject to FBT are not also assessed to the shareholder-employee as a dividend.

(8) Board and lodgings [s CD 32]
A dividend does not include any amount that is board and lodgings received in connection with employment. Such benefits are subject to PAYE deduction.

(9) Distributions by a statutory producer board on dissolution [s CD 26]
A dividend does not include any distribution made by a statutory producer board where the distribution is the return of all or part of a levy charged specifically for capital development and the distribution of that levy is made in the course of the statutory producer board’s dissolution.

(10) Distributions by a statutory producer board [s CD 33]
A dividend does not include any distribution made by a statutory producer board to a member where all of the following apply:
(a) The recipient was a member of the board at some time during the income year;
270.35(11) Dividends

(b) The amount of the distribution corresponds to a notional distribution amount that is treated as a dividend under s CD 13(1); and

c) The amount was based on the total produce transactions of members with the board during the tax year or the total levies payable by members to the board for the income year.

TaxNote 1: The CIR has some discretion to accept an alternative basis of calculation.

(11) Distribution by a statutory producer board [s CD 33]

Any distribution made by a statutory producer board is not a dividend where all of the following apply:

(a) The person was a member of the board at some time during the income year; and

(b) The amount is calculated on the basis of the member’s share of:

(i) The total produce transactions of members with the board during that income year; or

(ii) The total levies payable by members to the board for that income year; and

(c) The amount corresponds to a notional distribution amount treated as a dividend under s CD 13(1).

TaxNote 2: The CIR has some discretion regarding the calculation referred to in item (b).

(12) Distribution by a co-operative company [ss CD 33, CD 34]

Any distribution made by a co-operative company is not a dividend where all of the following apply:

(a) The person was a shareholder of the company at some time during the income year;

(b) The amount is calculated on the basis of the shareholder’s share of the total produce transactions between shareholders and the company during the income year; and

(c) The amount corresponds to a notional distribution amount which is treated as a dividend under s CD 13(3).

The distribution is treated as a return of capital for the purposes of the capital limitation and therefore is not deductible to the company. Section CD 34 allows a co-operative company to elect that distributions of profits arising from non-member transactions be treated as a rebate rather than a dividend. Certain conditions must be satisfied [see 225.45].

(13) Interest in a foreign investment fund (FIF) [s CD 36]

A dividend does not include an amounts distributed by a company where:

(a) The amount is derived from an interest in a company which is a FIF (or would have been a FIF had it not been liquidated); and

(b) The person calculates the FIF income or loss in the period by applying the comparative value (CV) method, deemed rate of return (DRR) method, cost method, or the DRR method where the FIF is not a grey-list company and the person does not hold a direct income interest of 10 per cent or more in the FIF at the beginning of the income year.

270.40 Available subscribed capital [s CD 43]

The purpose of the available subscribed capital formula is to determine the amount that shareholders have paid into the company when subscribing for its shares. This amount can be returned to shareholders free of tax when the company is wound up or on a repurchase of shares.

The formula under which the available subscribed capital for a share in a company is calculated is as follows:

\[ 1 \text{ July 1994 balance} + \text{subscriptions} - \text{returns} - \text{look-through company returns} \]

(1) 1 July 1994 balance

"1 July 1994 balance": if the company did not exist as at 1 July 1994, the 1 July 1994 balance is zero. If the company did exist as at that date, the 1 July 1994 balance is calculated as:

\[ \text{(paid up capital + premiums / all shares issued)} \times 30 \text{ June 1994 shares} \]

Where:
Dividends

“Paid-up capital” is the total amount of capital paid up before 1 July 1994 for shares of that class. It does not include an amount paid up by way of bonus issue unless it was a taxable bonus issue or the amount was paid up by way of an application of an amount of qualifying share premium. However, it does include paid-up capital that (before 1 July 1994), has been written off against losses incurred by the company. Hence, the written off capital is able to be restored by the company upon liquidation without the distribution to shareholders being taxed as a dividend [see Public ruling BR Pub 06/04, TIB vol 18:7 (August 2006) at 5-8].

“Premiums” is the total of qualifying share premiums paid to the company before 1 July 1994 for shares in that class but excluding amounts applied before 1 July 1994 in paying up capital. A share premium originates from the days when a share had a “par value”. If the shares were issued for more than par, the excess was a share premium that remained in a reserve and was able to be distributed as capital.

“All shares issued” is the number of shares in that class as at the end of 30 June 1994.

“All June 1994 shares” is the number of shares in the class on issue at the end of 30 June 1994.

(2) Subscriptions

“Subscriptions” is the total amount of consideration that the company received after 30 June 1994 and before the time for which the calculation is being done for that class of shares. Where a company has migrated and deemed by s FL 2(1) as having been liquidated, and having distributed the proceeds of the liquidation to shareholders, the amount of the deemed distribution is added to the company’s available subscribed capital (ASC), to remove the potential for double taxation in the event that the company pays a dividend in the future.

Sections CD 43(6) to CD 43(21) contain refinements to, and exclusions from, the term “subscriptions”. These relate to:

(a) Bonus issues [s CD 43(6) and (7)];
(b) Re-invested exempt dividends [s CD 43(8)];
(c) Share for share exchanges [s CD 43(9) and (10)];
(d) Share capital reorganisations [s CD 43(11) and (12)];
(e) Ineligible capital [s CD 43(13) and (14)];
(f) Amalgamations [s CD 43(15)];
(g) Emigrating companies [s CD 43(16)];
(h) Maori authorities [s CD 43(17)];
(i) Rule against double counting [s CD 43(18)];
(j) Treasury stock sales [s CD 43(19)];
(k) Superannuation fund’s interest in a group investment fund [s CD 43(20)];
(l) Foreign currency conversions [s CD 43(21)].

(3) Returns

“Returns” is the total amount of share capital that the company has returned to its shareholders by way of reacquiring its shares after 30 June 1994 and before the time in respect of which the calculation is being made. It includes only amounts that were not a dividend because of s CD 22 (off-market share cancellations) [see 270.35] or s CD 24 (on-market share cancellations) [see 270.35] or an equivalent provision of an earlier Act.

(4) Look-through company returns

“Look-through company returns” is the total amount of of share capital that the company has returned to its shareholders by way of reacquiring or cancelling its shares while the company was a look-through company [see 920].

Sections CD 43(22) to CD 43(24) contain refinements to, and exclusions from, the term “returns”. These relate to:

(a) On-market share cancellations by an associate [s CD 43(22)];
Available capital distribution amount [s CD 44]

The “available capital distribution amount” is:

- The amount of realised capital gains; \( \text{plus} \)
- The value of capital assets (less their cost) distributed to shareholders on the liquidation; \( \text{minus} \)
- Any capital losses arising in the 1992-1993 or later tax year,

that is able to be distributed tax-free on the liquidation of the company. The formula for calculating the available capital distribution amount is provides the available capital distribution amount per share. It is:

\[
\text{available capital distribution amount per share} = \frac{(\text{receipts} - \text{asc per share} \times \text{capital gains} + (\text{capital property distributed} - \text{cost}) - \text{capital losses}}{\text{total receipts} - \text{total sales}}
\]

The making of a resolution to adopt a course of action that will culminate in removal of a company from the New Zealand register starts the period during which the company is being liquidated. Where a short-form liquidation process under s 318(1)(d) of the Companies Act 1993 is to be used, any overt decision-making act provided for in the company’s constitution to adopt a course of action that will end in removal from the register without a request to the registrar having to be made marks the commencement of the “on liquidation” period. This first step will generally be the passing of the resolution to cease business. Anything that occurs during that period occurs “on liquidation” [see Public ruling BR Pub 10/06 (effective 1 January 2009 to 31 December 2014), TIB vol 22:5 (June 2010) at 3-7].

Sections CD 44(3) to (18) contain refinements to and exclusions from, the terms contained in the formula. These relate to:

- Negative multiplier [s CD 44(3)];
- Foreign company information [s CD 44(4)];
- Bonus issued capital gains [s CD 44(5)];
- Capital gains amounts [s CD 44(6) and (7)];
- Amalgamated companies [s CD 44(8)];
- Capital losses [s CD 44(9) and (10)];
- Associated persons transactions (effective 1 April 2010) [s CD 44(10B)];
- Close company liquidations (effective 1 April 2010) [s CD 44(10C)];
- Related person transactions [s CD 44(11)];
- Reinvested exempt dividends [s CD 44(13)];
- Amounts written up [s CD 44(14)];
- Available capital distribution amount 1988 to 2010 (relationship with s CZ (9B)) [s CD 44(14B)];
- Related person – meaning [s CD 44(15)];
- Relatives, nominees and interposed companies look-through [s CD 44(16) and (17)];
- Capital property – meaning [s CD 44(18)];

From the 2010-2011 income year, capital gain amounts and capital losses plus close company liquidations are dealt with under s CD 44(10B) and (10C) respectively. This is due to the impact of the new associated persons definition [see 70.60]. The sections provide that no capital gain amount is derived and no capital loss is incurred by a company where property is disposed of under an arrangement with an associated person unless the company is a close company, the associated person is not a company and the disposal occurs on the liquidation of the company.
Dividends

From the 2010-2011 income year, s CD 44(15) (meaning of “related person” and s CD 44(16) and (17) (relatives, nominees and interposed companies look-through) are repealed. This is also due to the revised definition of “associated person”.

The equivalent effect is preserved for the period 1 April 1988 to 31 March 2010 by s CZ 9B.

270.50 Ordering rule and slice rule [s CD 23]

The role of the ordering rule and the slice rule is to allocate the available subscribed capital to shares.

(1) Ordering rule

Under the ordering rule, the available subscribed capital for shares in a particular class is calculated as:

\[
\text{available subscribed capital of class} \div \text{shares being cancelled of class}
\]

Where:

“Available subscribed capital of class” is the available subscribed capital of all shares of the same class as the share under consideration, measured as at the time for which the amount is being calculated.

“Shares being cancelled of class” is the number of shares of the same class as the share (including the share) being cancelled at the time.

The effect of the formula is to allocate the available subscribed capital, in so far as it extends, to the shares which are being cancelled. This can give rise to little or no available subscribed capital remaining for the uncancelled shares and result in those shares being taxable on redemption.

Example:

Buyback Ltd was established with $100 share capital divided into 100 shares, all of the same class. Joe owned 50 of the shares and Sam owned the other 50. Some years ago, the company made a non-taxable bonus issue of $100, divided into 100 shares of the same class as the original shares. Joe and Sam each received 50 of the bonus issued shares. Last year, the company reacquired Joe’s shares. Now the company is to be liquidated.

When the company reacquired Joe’s shares, the available subscribed capital was $100. The allocation was calculated under the ordering rule as follows:

\[
\text{available subscribed capital of class} \div \text{shares being cancelled of class}
\]

As the bonus issue was a non-taxable bonus issue, it did not increase the company’s available subscribed capital. The available subscribed capital is $100 being the amount subscribed for the original 100 shares. The number of shares of the class being cancelled is 100, being Joe’s original 50 shares plus his 50 bonus issued shares. The calculation therefore becomes $100 / 100 shares or $1 per share being cancelled. Assuming that the company has $200 in cash representing its share capital and that it has no other reserves, Joe will have received $100 for his 100 shares, all of which would have been available subscribed capital and therefore non-taxable. When the company is liquidated, Sam will also receive $100 for his 100 shares. However, as there is no remaining available subscribed capital, Sam will be taxed on the entire amount.

(2) Slice rule

Under the slice rule, the formula for calculating the available subscribed capital per share is:

\[
\text{available subscribed capital of class} \div \text{shares of the class}
\]

Where:

“Available subscribed capital of class” is the available subscribed capital of all shares of the same class as the share under consideration, measured as at the time for which the amount is being calculated.

“Shares of the class” is the number of shares of the same class as the share (including the share) on issue at the time.

The effect of the formula is to allocate the available subscribed capital, in so far as it extends, over all of the shares in the class including those which are being cancelled and those which are to remain. Therefore, shareholders whose shares are not being cancelled are not disadvantaged in the way in which they are under the ordering rule.

270.55 Details of dividends required by CIR [TAA, s 67]

All imputation credit account companies declaring dividends are required to complete and retain a company dividend statement. In addition, a copy of any required statement must be forwarded to the CIR by the last
day for filing the income tax return for the income year which corresponds with the imputation year in which the dividend statement was required to be completed. The dividend statement must contain all of the following information:

(a) The number of shares in respect of which the dividend is declared or, if the dividend is a bonus issue, the number of shares included in the bonus issue;
(b) The date on which the dividend was declared and the date on which it was paid;
(c) The total amount paid or, if the dividend is a bonus issue, the amount of the bonus issue;
(d) The total amount of imputation credits attached;
(e) The imputation ratio of the dividend;
(f) If the dividend was paid in Australian currency by an Australian imputation credit account company, the exchange rate used to calculate the imputation ratio; and
(g) Any other information that the CIR may require.

270.60 Taxation of foreign dividends [s CD 19]

Dividends derived by a New Zealand resident individual from foreign companies are liable for New Zealand income tax in the same way as New Zealand dividends. The taxable dividends are the gross dividend (that is gross of any foreign tax) which is liable to income tax in New Zealand. Credit is given for the foreign tax paid up to the amount of the New Zealand tax on that segment of income [s LJ 2]. A double taxation agreement may also be applicable, and should be considered if a dividend is received from a country with which New Zealand has a DTA.

If a foreign dividend is received by a company in its capacity as a trustee of a trust, that foreign dividend will be subject to income tax and not exempted under the rule for companies in s CW 9.

For natural persons with income interests of greater than 10 per cent in a controlled foreign company that receive dividends from the CFC, these dividends are taxable in the normal manner. However, double taxation on the attributed CFC income and the dividend may be relieved through the operation of a branch equivalent tax account [ss OE 17 to OE 22, see 670.285 and 670.340]

For people with interests in a foreign investment fund, the FIF rules will apply in relation to the dividend. The FIF rules are set out at 850.130, with the relationship between the FIF rules and the ordinary dividend provisions explained at 850.235.

Although the dividend may be exempted from tax in the foreign country this does not make it exempt from New Zealand income tax when derived by New Zealand individual shareholders. Foreign sourced dividends derived while a person is a transitional resident are exempt [see 370.35].

270.65 Interests in foreign unit trusts [ss CD 9, CD 10, CD 30]

Historically, it has been possible for New Zealand residents to invest in Australian unit trusts and avoid paying tax on the income in either country. As a temporary measure, while work on the reform of the taxation of international investment continues, amendments have been enacted which apply from 21 December 2004. There are two parts to the measure. The first applies where property vests in a beneficiary, and the second relates to bonus issues that are re-invested.

Where a beneficiary of a unit trust that is a foreign company has a beneficial interest in money or property of the unit trust and that property vests in the beneficiary, a dividend arises. The amount of the dividend is the value of the money or property that has vested. Where an amount is a dividend under this provision it will not constitute a second dividend if and when the legal interest in the money or property passes to the beneficiary.

Where a unit trust that is a foreign company makes a bonus issue under an arrangement whereby the bonus issue is made instead of money or property vesting absolutely in the unit holder, the bonus issue is a taxable bonus issue and a dividend arises for the unit holder. The amount of the dividend is the value of the money or other property the vesting of which has been foregone.
270.70 **Dividends from UK building societies** [s CD 19]

Where UK building societies pay a “composite rate” of income tax on total distributions made to depositors who hold share or term deposit accounts with building societies, the composite rate is paid on behalf of the depositors and is intended to be an average rate of income tax that would be paid by the depositors if taxed individually. The net amount received by the depositors is not liable to UK income tax. In New Zealand, the net amount received by a depositor must be grossed up on the basis of the following formula:

\[
\frac{1}{\text{composite rate}} \times \text{net amount received}
\]

The grossed up figure is then included in the New Zealand tax return, and credit is allowed for the composite rate (with a maximum of the New Zealand tax payable on that income). The income may be a dividend or interest, depending upon the type of investment. If the income is from the share account (although frequently described as “interest on shares or dividends”) it is a dividend, while income on a term deposit is interest. Under UK law, distributions by building societies are not dividends, so the UK-New Zealand Double Tax Agreement does not apply to limit the UK tax to 15 per cent.

Before allowing credit, New Zealand requires evidence of the composite rate paid by the building society. Details of the composite rate are usually shown on a certificate issued by the building society to its members each year.

270.75 **Overview of dividends derived by individual shareholders** [ss CD 1, HA 14]

Dividends derived from:

(a) Resident companies that are not qualifying companies or

(b) Non-resident companies,

are income in the hands of individual shareholders.

Dividends derived from any qualifying company are income in the hands of shareholders if they are fully imputed, otherwise they are exempt.

Dividends on shares held under an employee share purchase scheme are regarded as income to the employee shareholders. They are treated in the same manner as any other class of dividend (ie, they are liable to income tax).

270.80 **Dividends derived by corporate shareholders** [ss CD 1, CW 9, CW 10, DB 55]

Dividends derived from any New Zealand resident company that is

(a) Not a qualifying company; and

(b) Not a wholly-owned subsidiary company,

are income in the hands of corporate shareholders.

Dividends derived by a New Zealand resident company, or as category A income of a group investment fund, from a wholly-owned subsidiary company, are generally exempt income [s CW 10]. However, after 30 June 2009, the exemption does not apply where the interest is:

(a) A direct interest of less than 10 per cent which is not an attributing FIF interest;

(b) A fixed-rate foreign equity; or

(c) Rights to a deductible foreign equity distribution.

Dividends derived from a non-resident company by a resident corporate shareholder (not being a multi-rate PIE), or as Category A income of a group investment fund, are exempt income [s CW 9]. However, for income year beginning on or after 1 July 2009, under s CW 9(2), the following dividends are excluded from this exemption and subject to income tax in the normal manner:
(a) Dividends from a less than 10 per cent interest in a FIF described in ss EX 31, EX 32, EX 36, EX 37, EX 37B or EX 39. These comprise shares in ASX-listed Australian companies, Australian unit trusts with adequate turnover or distributions, certain venture capital investments into New Zealand companies that have since migrated to a grey-list country, and shares in Guinness Peat Group plc [see 850.145];
(b) Dividends from fixed-rate foreign equity; and
(c) Dividends from deductible foreign equity.

Fixed-rate foreign equity and deductible foreign equity are defined in s YA 1. Fixed-rate foreign equity includes foreign dividends that are a specific fixed percentage of the amount paid for the equity (as well as variations on this) and any dividend that is regarded as equivalent to payment for money lent.

A deductible foreign equity distribution is a dividend where the foreign company paying the dividend (or a company in the same group or further up the chain as the foreign company) is allowed a deduction for the payment of the dividend against foreign income tax.

Previously, a resident corporate shareholder had an obligation to meet a quarterly foreign dividend payment in relation to that exempt dividend [see 670.120]. The dividend withholding payment rules have been repealed for all income years beginning on or after 1 July 2009.

With effect from the 2005-2006 income year, companies receiving exempt dividends from foreign companies are able to claim a deduction for expenditure incurred in deriving those dividends [s DB 55]. When the company is not a conduit tax relief company, the expenditure is deductible in full. When the company is a conduit tax relief company, the expenditure is deductible to the extent provided by the following formula:

\[
\text{expenditure} \times (1 - \text{non-resident shareholding})
\]

Where:

“Expenditure” is the expenditure incurred in deriving the dividend;
“Non-resident shareholding” is the fraction of the company’s shareholders that are non-residents, calculated under s RG 7(3) and (4).

**TaxNote:** Subpart LQ, that gave a tax credit for conduit tax relief companies, and s DB 55, which limits the ability for a company to claim a deduction for the cost of deriving exempt dividends, have been repealed for income years beginning on or after 1 July 2009.

### Other miscellaneous dividend provisions [ss GB 23, GB 25]

There are other transactions between shareholders and a company which are deemed to be dividends by virtue of other provisions:

(a) Excessive remuneration for services rendered to a director or shareholder of a close company (or a relative) [s GB 25]; and

(b) Excessive remuneration payable to a relative of a shareholder or director of a company other than a close company [s GB 23].

Amounts arising under a dividend stripping arrangement are dividends [see 80.22]. However, they are excluded from the definition of dividend for the purposes of certain provisions relating to:

(a) Consolidated groups;

(b) Subpart OE, which relates to branch equivalent tax accounts (BETA);

(c) Subpart OJ, which relates to policyholder credit accounts;

(d) The foreign dividend payment (FDP) rules; and

(e) The imputation rules.

### Dividend recovered by a company [s CD 40]

A company may recover dividends paid on failure to pass the “solvency” test in the Companies Act 1993. Where any dividend is subsequently recovered by the company from a shareholder under s 56 of the
Companies Act 1993 (or the equivalent provision of any company legislation of a country or territory other than New Zealand):

(a) The CIR must, if notified in writing of the recovery, notwithstanding the time bar, amend any income tax assessment of the shareholder and make an appropriate refund; and

(b) A credit or debit arises, where necessary, in the imputation credit account or dividend withholding payment account, as the case may be.

270.95 Non-cash dividends

A dividend includes any transfer of value from a company to a person if the cause of the transfer is a shareholding in the company and the transfer is not excluded from being a dividend by any of ss CD 22 to CD 36.

Given the breadth of the dividend definition, it is clear that the term can include transfers of value other than in cash. This has consequences in terms of:

(a) Income tax;

(b) Resident withholding tax (RWT);

(c) Non-resident withholding tax (NRWT); and

(d) Imputation credits;

Non-cash dividends are:

(a) Assessable to the recipient;

(b) Able to carry imputation credits;

(c) Liable to RWT if not fully imputed; and

(d) Liable to NRWT when paid to a non-resident shareholder.

RWT is calculated in accordance with the formula in s RE 14 or, in the case of a taxable bonus issue, in s RE 15. This is done by grossing up the dividend and applying RWT to the gross amount. The deemed deduction should be paid to the IRD by the 20th of the month following the month when the deduction is deemed to have been made [see 1260.45 and 1260.50]

FBT, not RWT, applies to benefits provided to shareholders who are also employees. A non-executive director is not treated as an employee [s CX 17]. Non-cash benefits received by a non-executive director shareholder are exempt from FBT but are subject to the dividend rules under s CX 17 when the recipient has no other employment relationship with the company beyond the formal occupation and statutory obligations of a non-executive director [see 540 FRINGE BENEFIT TAX]. Non-cash dividends passing between 100 per cent wholly-owned companies are exempt [s CW 10].
Chapter 300
Donations and Subscriptions

300.10 Donations
Donations are generally not allowable as a deduction, as they are a disposition of income and not a cost of earning it. However, an individual may claim a “refundable tax credit” under s LD 1 for cash gifts of $5 or more to charitable and other public benefit organisations in New Zealand. The amount of the tax credit is one-third of the total gifts made by the taxpayer in the tax year. No tax credit is allowed for any gifts to the extent to which they exceed the person’s taxable income for the tax year. The term “charitable or other public benefit gift” is defined in s LD 3 [see 150 CHARITIES].

The credit is not available to absentees, companies, public authorities, Maori authorities, unincorporated bodies, or trustees of complying trusts, foreign trusts or non-complying trusts.

The credit is claimable by applying to the CIR on the approved form. Taxpayers are not limited to making only one claim for each year but claims cannot be made before 1 April following the end of the income year (standard and early balance date taxpayers) or the day following the end of the taxpayer’s income year (late balance date taxpayers). Early claims can be accepted from persons leaving New Zealand permanently or for a significant time and from trustees of deceased estates [see 1395.75].

Inland Revenue has ruled that, where fund raising by approved charities includes sale of tickets to attend such functions as concerts, movie premieres, and dinners, only the donation element of the ticket price will qualify as a donation for rebate or deduction purposes. Any element of the purchase price which provides benefit to the purchaser (eg dinner or entertainment) will not be recognised as a donation.

300.20 Gifts to charities by companies and Maori Authorities
Companies and Maori authorities may claim a deduction for any gift of money made by it to any of those organisations, societies, trusts, or funds to which the donations tax credit under s LD 1 applies. Maori authorities are also able to claim a deduction for donations made to a Maori association.

The available deduction is limited to the net income of the company or Maori authority for that year before making the deduction.

300.30 Club membership
The extent to which club subscriptions are deductible is discussed below.

1) Self-employed business or professional persons
The subscription is deductible if it is paid to a professional, business, or similar club (but not to a sporting club) and the club is used frequently and regularly for business purposes (eg to meet and entertain clients, both existing and prospective) or for business lunches or discussions.

2) Key-employees and shareholder-employees of small companies
The subscription is deductible provided there is a direct relationship between the club (which may include a sports club) and the business of the company (eg sports goods representative and golf or tennis club), and the dominant reason for membership is for business purposes. In these cases one subscription per key employee or shareholder-employee may be deducted by the company.
300.30(3) Senior staff members of large companies

Large companies which pay subscriptions to clubs in different cities for senior staff members are allowed a deduction for subscriptions paid for those members to belong to one club in each city for the purpose of transacting the company’s business and entertaining clients.

**TaxNote:** The CIR has no statutory reason for restricting club subscriptions to just one club for employees and one club in each city for senior staff. Depending on individual circumstances, it may be possible to demonstrate that more than one such subscription meets the tests of deductibility.

### 300.40 Subscriptions allowable

Subscriptions are allowable as a deduction to businesses, but not to employees, insofar as they are an expense which meets the requirements of the general permission in s DA 1 [see 240 DEDUCTIONS]. Prepaid expenditure as at balance date comprising subscriptions for membership of any trade, professional, or other association may not need adjustment if they are within Determination E12 [see 1140.70].

The following are examples of subscriptions that are deductible provided that a nexus exists between the payment and the income-earning process of the taxpayer:

(a) Agricultural and pastoral societies;
(b) Associations to ensure protection of a trade;
(c) Automobile Associations and Commercial Travellers’ Associations;
(d) Chambers of Commerce — no deduction of a levy for special purposes is permissible unless it would have been deductible under s DA 1;
(e) Employers’ associations;
(f) Employee benefit funds [s DC 6];
(g) Employer subscriptions for staff groups to the British United Provident Association;
(h) Farm Forestry Association;
(i) Federated Farmers of New Zealand Inc;
(j) National Safety Association of New Zealand;
(k) New Zealand Association of Opticians and Optometrists;
(l) New Zealand Institute of Management annual subscriptions;
(m) New Zealand Mill Owners’ Research Association;
(n) New Zealand Dental Association Research Foundation — claimable within the limits of s DB 33;
(o) New Zealand Fertiliser Manufacturers Association;
(p) New Zealand Institute of Economic Research — claimable within the limits of s DB 33;
(q) Outward Bound Trust fees paid by employers for employees as staff training;
(r) Professional societies;
(s) Public relations offices subscriptions — but donations are non-deductible unless an advertising benefit arises;
(t) Trade associations; and
(u) Trade journals.

### 300.50 Subscriptions not allowable

Payments to the following bodies are not deductible as they are considered to be expenditure of a private nature:

(a) Citizens’ and ratepayers’ associations;
(b) Contributions by firms in the motor trade to the New Zealand Motor Trade Certification Board;
(c) Donations to public relations offices;
(d) Donations to political parties;
(e) Contributions to the Wool Action Committee;
(f) Subscriptions paid to the New Zealand Business Roundtable;
(g) Subscriptions paid to the New Zealand Federation of Business and Professional Women’s Clubs.
## Chapter 310

### Double Tax Agreements

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A double tax agreement (DTA) is an agreement that has been negotiated and agreed between the New Zealand Government and the Government of any territory outside New Zealand and has entered into force as a result of a declaration by the Governor-General by Order in Council. A double tax agreement also includes an agreement between the Taipei Economic and Cultural Office in New Zealand and the New Zealand Commerce and Industry Office.

Double tax agreements may be negotiated for the following purposes:

(a) To provide relief from double taxation;
(b) To provide relief from tax;
(c) To tax the income derived by non-residents from any source in New Zealand;
(d) To determine the income to be attributed to non-residents or their agencies, branches or establishments in New Zealand;
(e) To determine the income to be attributed to New Zealand residents who have special relationships with non-residents;
(f) To prevent fiscal evasion;
(g) To facilitate the exchange of information;
(h) To assist in recovering unpaid tax.

Where a double tax agreement refers to the profits of an activity or business, that reference is to be read, if possible, as a reference to the amount that would be a their net income if that activity or business were the taxpayer’s only activity or business.

Where a double tax agreement refers to two persons being unrelated, this is to be read, if possible, as a reference to two persons being not associated.

### Avoiding double taxation

Double taxation can arise when taxpayers are liable to tax in more than one country. For example, a person may be liable to tax in country A, because they are resident in that country, but also liable to tax on the same income in country B, because the income is derived from country B. Consequently, double taxation agreements are entered into between nations and have two main purposes:

(a) To define which country has the right to tax income of specified classes; and

(b) To provide for the exchange of information between the countries which are parties to the agreement.

The agreements prescribe the method of assessment of certain specific classes of income, but many classes of income are not specifically referred to in the agreements and, therefore, this unspecified income is taxed according to the laws of the countries which are parties to the agreements. Where the income is specified in
Double Tax Agreements

310.15

the agreement then in addition to there being rules relating to how and where it is to be taxed, there are also rules which specify whether there should be credits granted for any foreign tax paid. Generally, the country of origin of the income has the primary right to tax and the country of residence has the obligation to grant a credit.

The manner of interpretation of double taxation agreements was considered by the Court of Appeal in Commissioner of Inland Revenue v United Dominions Trust Ltd (1973) 1 NZTC 61,028 (CA). An agreement is not interpreted solely in the light of doctrines peculiar to domestic law but must be construed as a whole after taking into account its object and purpose. For example see TES 19 (September 2004) 272.

310.15 Impact on domestic law [ss BB 3(2), BH 1; TAA, s 88]

A double tax agreement which has been negotiated between New Zealand and another country is given the force of law in New Zealand by an Order in Council under s BH 1(3). In relation to income tax or any other tax imposed by the ITA (including the exchange of information relating to a tax), a double tax agreement overrides anything in:

(a) The ITA [except for s BH 1(5)];
(b) Any other Inland Revenue Act;
(c) The Official Information Act 1982; and
(d) The Privacy Act 1993 [ss BB 3(2), BH 1(4)].

For “exchange of information” purposes, “tax” is defined as having the meaning given by paragraphs (a)(i) to (v) of the definition of “tax” in s 3 of the TAA. The effect of ss BB 3(2) and BH 1(4) is that a double taxation agreement, to the extent that it has any provision which is inconsistent with the New Zealand domestic law, overrides domestic law.

Example:
The ITA 2007 provides that certain classes of income are deemed to be derived from New Zealand including income derived from a business wholly or partly carried on in New Zealand [s YD 4(2)]. However, most double taxation agreements provide that the industrial or commercial profits of an enterprise of one of the contracting states is not liable for tax in the other contracting states unless the enterprise carries on business in the other contracting state conducted through a “permanent establishment” there.

Each agreement provides a modification of domestic law by giving the country of origin of the income the primary right to tax certain classes of income arising in that country, with credit being given in the country of residence for tax paid in the country of origin, and by declaring that certain other classes of income are to be taxed only in the country where the recipient of the income resides. In most agreements a provision is contained whereby dividends, interest, or royalties are taxed by the country of origin at rates lower than the rates applying to non-residents deriving income from similar sources but who reside in a country which is not a party to a double taxation agreement.

The CIR may disclose any information required to be disclosed under a double tax agreement to the authorised tax authorities in the other country which is party to the agreement. This authority overrides any secrecy obligation imposed by any enactment [TAA, s 88].

All New Zealand agreements are the “credit” type, except for the New Zealand-Sweden agreement, which provides exemption in lieu of credits. In the United States-New Zealand agreement the credit provisions have to be applied to all income with a source in the United States.

310.20 Income assessed on an origin basis

The following are examples of income assessed on an origin basis.

(a) Income derived by an enterprise of one of the contracting states from industrial or commercial profits from a business carried on through a permanent establishment of the enterprise situated in the other contracting state. There is usually a clause designed to ensure that the profits of the permanent establishment subject to tax in the country of origin are not less than might be expected if all transactions were made on an arm’s length basis.
(b) Industrial royalties.
(c) Income from land and the exploitation of land or landed property, rents, natural resource royalties, farming and agricultural profits, and forestry.

310.25 Income assessed on a residence basis

The following are examples of income assessed on a residence basis.

(a) Profits of an enterprise carried on in one of the contracting states except to the extent that those profits are attributable to a business carried on in the other contracting state through a permanent establishment situated there. In *JFP Energy Inc v Commissioner of Inland Revenue* (1989) 11 NZTC 6,282 (HC), the Court considered art 15 of the United States-New Zealand agreement, which provides that remuneration derived by a resident of a contracting state for an employment exercise in the other contracting state shall be taxable only in the first-mentioned state if the remuneration is not “borne by” a permanent establishment or a fixed base which the employer has in the other state. The Court held that, to determine whether remuneration is “borne by” a New Zealand permanent establishment, reference may be had as to the presence or absence of the expense in the accounting records relating to that New Zealand establishment. However, attribution in the accounts is less significant than the actuality of where the expenditure comes to rest.

(b) Profits from operating ships or aircraft in international traffic.

(c) Salaries, wages, or similar remuneration, unless the employment is exercised in the other country for a period exceeding 183 days in the income year or in later agreements 183 days in a 12-month period and the other provisions in the respective agreement are met.

(d) Income from independent professional personal services (except public entertainers), unless the person concerned has a fixed base regularly available in the contracting state where not normally resident.

(e) Pensions or annuities.

(f) Employee’s remuneration paid by a government to one of its servants in the other territory if the employee is not a resident of the country where working or is resident there solely for the purpose of rendering the service.

(g) Remuneration of a professor or teacher present in the other contracting state for the purpose of teaching at an educational institution for a period not exceeding two years.

(h) Payments received by a student or business apprentice visiting the other country solely for the purpose of education or training, if the payments are received from outside the country visited.

(i) Income derived by a resident of one of the states from outside both states.

310.30 Refunds for tax paid [TAA, s 184]

If a DTA exempts from tax income derived before the date of the Order in Council that gives effect to the DTA, and tax has been paid on that income, the CIR may (despite ss LA 6 to LA 8, RM 2, RM 4 to RM 6, RM 8 and RM 10) refund that tax if written application is made by or on behalf of the taxpayer within four years after the date the agreement came into effect.

310.35 Tax sparing

Tax sparing arrangements are concessions provided under some of the double tax agreements to which New Zealand is a signatory. Tax sparing, which is designed to eliminate or reduce double taxation, allows a taxpayer to claim a credit for tax that the double tax agreement deems to have been paid in a foreign country. New Zealand has tax sparing arrangements with China, Fiji, India, Korea, Malaysia and Singapore.

A taxpayer claiming a foreign tax credit in respect of a tax sparing arrangement must complete a tax sparing disclosure return (IR 486).

Credit is also available for foreign taxes paid under statutory provisions [see 760.40, 760.45].
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310.40 New Zealand’s double tax agreements

New Zealand has a network of double tax agreements with the countries which are its main trading and investment partners. Although the agreements are broadly similar, each one has some unique feature or features. The countries with which New Zealand has agreements in force, and the main features of those agreements, are set out in 310.45 to 310.200.

Note: The information presented in 310.45 to 310.200 is a summary only of the principal features of the agreements. Only the provisions that are likely to be most commonly used have been covered. No action or decisions should be taken in respect of any of the following classes of income without first consulting the full text of the agreement. For example, each of the agreements has exemptions or exclusions that may apply to particular income types, and terms such as “permanent establishment” and “resident” may be differently defined in each agreement [see Brookers Tax Service for the full text of the agreements].

(1) New and amended agreements

New Zealand signed a double tax agreement with Turkey on 22 April 2010. The agreement came into force on 28 July 2011.

A protocol to amend the double tax agreement with the United States, signed on 1 December 2008, came into force on 12 November 2010. See 310.200 for details.

It was announced on 12 August 2011 that, with retrospective effect from 1 May 2010:

- New Zealand’s double tax agreement with Chile [310.60] has been modified by the reduction in the withholding tax rate on royalties paid between residents of the two countries from 10 per cent to five per cent.
- New Zealand’s double tax agreement with Mexico [310.127] has been modified by the reduction in the withholding tax rate on dividends paid between residents of the two countries from 15 per cent to either five per cent or zero, depending on the investor’s shareholding in the company.

A second protocol to amend the double tax agreement with Belgium was signed on 7 December 2009. It has yet to enter into force.

Negotiations for double tax agreements with Luxembourg (commenced 2009), Vietnam (commenced 2010) and Papua New Guinea (commenced 2011) and are continuing. Negotiations for revised double tax agreements with Austria, Belgium, Canada, India, Malaysia, the Netherlands, and the United Kingdom are in progress (International Treaties List, January 2012, Ministry of Foreign Affairs & Trade).

310.45 Australia

The current double tax agreement between New Zealand and Australia was signed on 26 June 2009 and came into force on 19 March 2010 as the Double Taxation Relief (Australia) Order 2010. In New Zealand the agreement applies from 1 May 2010 for withholding taxes, and from income years beginning 1 April 2010 for other provisions. In Australia it applies from 1 May 2010 for withholding taxes, and from years of income beginning 1 July 2010 for other provisions. The 2009 agreement replaces the previous 1995 double tax agreement — see Staples Tax Guide 2010 for details of the 1995 agreement.

The main provisions of the 2009 agreement are summarised below. They are covered in more detail than for other double tax agreements because of New Zealand’s close association with Australia.

- Article 6 – Income derived by a resident of one state from real property (including the profits of an enterprise from agriculture, forestry or fishing) may be taxed in the state in which the real property is situated. This applies to income derived from the direct use, letting, or use in any other form of real property. For the purposes of art 6, “real property” has the meaning that it has under the law of the state in which the property is situated and specifically includes:
  (a) Natural resources, property accessory to real property, rights to which the provisions of general law respecting property apply, and rights to standing timber;
  (b) A lease of land and any other interest in or over land, whether improved or not, including a right to explore for natural resources, and a right to exploit these resources; and
(c) A right to receive payments (fixed or variable) either as consideration for or in respect of the exploitation of, or for the right to explore for or exploit, natural resources.

• Article 7 – Business profits are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to that permanent establishment. For this purpose, the profits attributed to that permanent establishment are those that it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment. Where profits include items of income that are dealt with separately in other Articles of the agreement, the provisions of those Articles take precedence.

• Article 8 – The profits of an enterprise that is resident in one state from the operation of ships or aircraft in international traffic are taxable only in that state. However, amounts paid to an enterprise resident in one state for carriage by ship or aircraft of passengers, livestock, mail, goods or merchandise that are both shipped and discharged in the other state may be taxed in that other state. This includes amounts paid for leasing a ship or aircraft on a full basis for such carriage, and profits from the operation of ships or aircraft derived through participation in a pooling or other profit sharing arrangement. Profits from the operation of ships or aircraft in international traffic include profits from the use, maintenance or rental of containers used in the transport of goods.

• Article 9 – Where an enterprise resident in one state is associated with an enterprise resident in the other state, the profits attributed to each enterprise may be adjusted to reflect independent, arm’s-length dealings if the commercial or financial relations between the two enterprises are not those that would be expected to operate between independent enterprises. For this purpose, two enterprises are considered to be associated if one enterprise participates directly or indirectly in the management, control or capital of the other enterprise, or if the same persons participate directly or indirectly in the management, control or capital of both enterprises.

• Article 10 – Dividends paid by a company resident in one state may be taxed in the other state if the dividends are beneficially owned by a resident of the other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to:
  (a) Five per cent of the gross dividend if the shareholder is a company which holds directly at least 10 per cent of the voting power in the company paying the dividend;
  (b) Fifteen per cent of the gross dividend, in all other cases.

No tax is payable on dividends if the shareholder is a company that is resident in the other state and has owned, directly or indirectly (through one or more residents of either state) shares representing 80 per cent or more of the voting power of the company paying the dividends for at least 12 months before the date the dividend is declared. This applies only if the shareholder company:
  (a) Has its principal class of shares listed on a recognised stock exchange and is regularly traded on one or more recognised stock exchanges;
  (b) Is owned directly or indirectly by one or more companies whose principal class of shares is listed on a recognised stock exchange and is regularly traded on one or more recognised stock exchanges;
  (c) Is owned directly or indirectly by one or more companies which, if they owned the shares directly, would be entitled to equivalent benefits in respect of those dividends under a tax treaty between the two countries; or
  (d) Does not meet any of the above requirements, but the competent authority (ie Inland Revenue or the ATO) of the state in which the company paying the dividend is resident determines that the company has not entered into arrangements with the main purpose of taking advantage of art 10.

• Article 11 – Interest arising in one state and derived by a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest. No tax is payable on interest if:

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(a) The interest is derived by one of the states or by a political subdivision or a local authority thereof (including a government investment fund), or by a bank performing central banking functions in the state; or

(b) The interest is derived by a bank or similar institution which is unrelated to and dealing wholly independently with the payer of the interest. In the case of interest arising in New Zealand, the exemption only applies if the person paying the interest has paid the approved issuer levy [see 1020.80]. The exemption does not apply if the interest is paid as part of an arrangement involving back-to-back loans or an arrangement of similar effect.

• Article 12 – Royalties arising in one state and derived by a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to five per cent of the gross royalties. The term “royalties” is defined as payments or credits, whether periodical or not, and however described or computed, to the extent to which they are made as consideration for:

(a) The use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trademark or other like property or right;

(b) The supply of information concerning technical, industrial, commercial or scientific experience;

(c) The supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right as is mentioned in (a) or any such information as is mentioned in (b);

(d) The use of, or the right to use:

(i) Motion picture films;

(ii) Films or audio or video tapes or disks, or any other means of image or sound reproduction or transmission for use in connection with television, radio or other broadcasting;

(e) The use of, or the right to use, some or all of the part of the radiofrequency spectrum as specified in a spectrum licence of a state, where the payment or credit arises in that state; or

(f) Total or partial forbearance in respect of the use or supply of any property or right referred to above.

• Article 14 – Income from employment is taxable only in the state of which the employee is a resident. However, if employment is exercised in the other state, that other state may tax the income derived from that other state. This may be overridden by any of arts 16 (directors’ fees), 18 (pensions) or 19 (government service). Income from employment exercised in the other state is taxable only in the employee’s state of residence if:

(a) The employee is present in the other state for a total of 183 days or less in any 12-month period;

(b) The remuneration is paid by, or on behalf of, an employer who is not resident in the other state, or is borne by or deductible in determining the profits attributable to a permanent establishment which the employer has the state of residence; and

(c) The remuneration is not borne by or deductible in determining the profits attributable to a permanent establishment the employer has in the other state.

Remuneration derived from employment on board a ship or aircraft operating in international traffic is taxable only in the employee’s state of residence.

Remuneration derived by an individual who is resident of one state in respect of a secondment to the other state is taxable only in the employee’s state of residence if the individual is present in the other state for a total of 90 days or less in any 12-month period.

• Article 15 – A fringe benefit, which would otherwise be taxable in both states, is taxable only in the state that has the primary right to tax the employment income of the employee concerned.
• Article 16 – Directors’ fees and other similar payments derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 17 – The income of entertainers and sportspersons is generally taxable in the state in which their personal activities as an entertainer or sportsperson are exercised. This applies whether the income from such activities accrues to the entertainer or sportsperson personally, or to another person (eg a company). Article 17 overrides arts 7 (business profits) and 14 (employment income). These rules do not apply to the income derived from personal activities of sportspersons as members of a recognised team regularly playing in a trans-Tasman league competition, unless the person is performing as a member of a national representative team of New Zealand or Australia.

• Article 18 – Pensions (including government pensions) and similar periodic remuneration are taxable only in the state of which the recipient is a resident. However, if the income (other than portable New Zealand superannuation, portable veteran’s pension or equivalent portable payments arising in New Zealand) would be tax-free in the source state if paid to a resident, then it will also be treated as tax-free in the state in which the recipient is resident. This means, for example, that a pension that is tax-free in New Zealand will continue be tax-free if the recipient moves to Australia. The following payments arising in one state (the source state) and paid to a resident of the other state are taxable only in the source state:
  
  a. Lump sums paid under a retirement benefit scheme, or in consequence of retirement, invalidity, disability or death, or by way of compensation for injuries;
  
  b. Alimony or other maintenance payments.

310.47 Austria

The Double Taxation Relief (Austria) Order 2007 was signed on 21 September 2006 and came into force on 1 December 2007. In New Zealand it applies for withholding taxes from 1 March 2008, and for all other taxes for income years beginning on or after 1 April 2008. In Austria it applies for withholding taxes from 1 March 2008, and for all other taxes for assessment years beginning on or after 1 January 2008.

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture, forestry or fishing) situated in the other state may be taxed in that other state.

• Article 7 – The profits of an enterprise are taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to that permanent establishment.

• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.

• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.

• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.

• Article 14 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  
  a. The recipient is present in the other state for 183 days or less in any 12-month period commencing or ending in the year of income; and

  b. The remuneration is paid by or on behalf of an employer who is not a resident of the other state; and
(c) The remuneration is not deductible in determining the taxable profits of a permanent establishment which the employer has in the other state.

- Article 15 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.
- Article 16 – Income derived by entertainers and sportspersons resident in one state from their personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person. Certain exemptions apply.
- Article 17 – Pensions paid in consideration of past employment are taxable only in the state of which the recipient is a resident. Pensions paid under the social security legislation of one state to a resident of the other state are taxable only in that other state.
- Article 20 – Types of income not covered by previous articles, wherever arising, may be taxed in the state in which the recipient is resident. If the income is derived from sources in the other state, it may also be taxed in that other state.

310.50 Belgium

The Double Taxation Relief (Belgium) Order 1983 was signed on 15 September 1981 and came into force on 8 December 1983. In New Zealand it applies from 1 April 1984. In Belgium it applies from 1 January 1984 for income subject to withholding tax. For all other taxes it applies from 1 January 1984. The second protocol to the agreement was signed on 7 December 2009.

The main provisions of the agreement are:

- Article 6 – Income derived by a resident of one state from real property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.
- Article 7 – Business profits are taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to that permanent establishment.
- Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
- Article 11 – Interest arising in one state and derived by a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.
- Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.
- Article 14 – Income derived by an individual from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, income from such services is taxable only in the other state if the services are performed in that other state and:
  (a) The individual is present in the other state for more than 183 days in the income year or taxable period concerned; or
  (b) The individual has a fixed base in the other state.

Income from services performed in the other state is taxable in that other state only to the extent that the income is attributable to activities performed during such periods of presence, or connected with that fixed base.

- Article 15 – Employment income is taxable only in the state of which the employee is a resident. However, if employment is exercised in the other state, that other state may tax the income derived from that other state. Income from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The employee is present in the other state for 183 days or less in the income year or taxable period concerned;
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(b) The remuneration is paid by an employer who is not resident in the other state; and

c) The remuneration is not borne by a permanent establishment or fixed base the employer has in
the other state.

• Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other
state may be taxed in that other state. Remuneration that a director receives for day-to-day managerial
or technical functions is treated the same as employment income under art 15.

• Article 17 – Income derived by resident of one state from their personal activities as an entertainer or
athlete in the other state may be taxed in that other state. This applies whether the income from such
activities accrues to the entertainer or athlete personally or to another person.

• Article 18 – Pensions paid in consideration of past employment are taxable only in the state in which
the recipient is a resident.

310.55 Canada

The Double Taxation Relief (Canada) Order 1981 was signed on 13 May 1980. The agreement is in force
from 29 May 1981. In New Zealand it applies from 1 April 1976 for income subject to withholding tax. For
all other taxes it applies to income years commencing on or after 1 April 1976. In Canada it applies from
1 January 1976 for income subject to withholding tax. For all other taxes it applies from 1 January 1976.

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from real property (including income from
agricultural, pastoral or other farming activities and forestry) situated in the other state may be taxed
in that other state.

• Article 7 – Industrial or commercial profits are taxable only in the state in which the enterprise is
resident. However, if the enterprise carries on business through a permanent establishment situated in
the other state, that other state may tax the profits attributable to the permanent establishment.

• Article 10 – Dividends received by a resident of one state from a company resident in the other
state may be taxed in the state in which the shareholder is resident. Such dividends may also be taxed in the
state that the company is resident, but that tax is limited to 15 per cent of the gross dividend.

• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that
other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 15 per
cent of the gross interest.

• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that
other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 15 per
cent of the gross royalty.

• Article 14 – Income from personal (including professional) services is normally taxable only in the
state of which the recipient is a resident. However, if the services are performed by a resident of one
state, in the other state, that other state may tax the income derived from that other state. Income derived
by a resident of one state from personal services performed in the other state is taxable only in the
employee’s state of residence if:

(a) The recipient is present in the other state for 183 days or less in the income year or taxation
year;

(b) The income is paid by a person who is not a resident of the other state; and

(c) The income is not borne by a permanent establishment or fixed base which that person has in
the other state.

• Article 15 – Directors’ fees derived by a resident of one state from a company resident in the other
state may be taxed in that other state.

• Article 16 – Income derived by a resident of one state from personal activities as an entertainer or
athlete exercised in the other state may be taxed in that other state. If the services are provided by an
enterprise, the profits from those services may be taxed in the state in which the enterprise is resident
unless:

(a) The enterprise is substantially supported from public funds of the state of residence; or
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(b) The enterprise is a non-profit organisation.

- Article 17 – Pensions and annuities arising in one state and paid to a resident of the other state are taxable in that other state. Such pensions and annuities may also be taxed in the state in which they arose if they exceed 10,000 Canadian dollars in any taxation year or income year. In this case, the amount of tax may not exceed:
  (a) The lesser of 15 per cent of the gross pension and a rate determined by reference to the recipient’s marginal tax rate; or
  (b) 15 per cent of the amount of the annuity that is taxable in that state.

310.60 Chile

The Double Taxation Relief (Chile) Order 2004 was signed on 10 December 2003 and came into force from 21 June 2004. In New Zealand it applies for withholding taxes from 1 January 2007. For all other taxes it applies for income years beginning on or after 1 April 2007. In Chile it applies for taxes on income obtained and amounts paid, credited to an account, put at the disposal or accounted as an expense, from 1 January 2007.

The main provisions of the agreement are:

- Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.
- Article 7 – Business profits are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.
- Article 10 – Dividends derived by a resident of one state from a company resident in the other state may be taxed in the state in which the shareholder is resident. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend (in the case of New Zealand), and tax in accordance with Chilean law (in the case of Chile).
- Article 11 – Interest arising in one state and derived by a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest, when derived from loans granted by banks and insurance companies, and 15 per cent of the gross interest, in other cases.
- Article 12 – Royalties arising in one state and derived by a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to five per cent (10 per cent before 1 May 2010) of the gross royalty.
- Article 14 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the income derived from that other state. Income derived by a resident of one state from personal services performed in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in any 12-month period;
  (b) The income is paid by a person who is not a resident of the other state; and
  (c) The income is not borne by a permanent establishment which that person has in the other state.
- Article 15 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.
- Article 16 – Artistes and sportspersons are generally taxable in the state in which their personal activities as an artiste or sportsperson are exercised. This applies whether the income from such activities accrues to the artiste or sportsperson personally, or to another person.
- Article 17 – Pensions (including government pensions) are taxable only in the state in which the recipient is a resident.

310.65 China

The Double Taxation Relief (China) Order 1986 was signed on 16 September 1986 and came into force from 17 December 1986. In New Zealand it applies from 1 April 1987. In China it applies from the tax year...

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from immovable property situated in the other state may be taxed in that other state.
• Article 7 – The profits of an enterprise are taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.
• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.
• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.
• Article 14 – Income derived by a resident from professional services or other activities of an independent character is normally taxable only in the state in which the person is resident. However, income from such services is also taxable in the other state if the services are performed in that other state and:
  (a) The individual is present in the other state for more than 183 days in any 12-month period; or
  (b) The individual has a fixed base in the other state.
• Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in any 12-month period;
  (b) The remuneration is paid by a person who is not a resident of the other state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base that the employer has in the other state.
• Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.
• Article 17 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.
• Article 18 – Pensions paid in consideration of past employment are taxable only in the state in which the recipient is a resident. Pensions paid under a public welfare scheme or social security system may be taxed in the state in which the pension is paid.

310.68 Czech Republic

The Double Taxation Relief (Czech Republic) Order 2008 was signed on 26 October 2007 and came into force on 2 September 2008. In New Zealand it applies for withholding taxes from 1 January 2009, and for all other taxes for income years beginning on or after 1 April 2009. In the Czech Republic it applies for withholding taxes from 1 January 2009, and for all other taxes for taxable years beginning on or after 1 January 2009.

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture, forestry or fishing) situated in the other state may be taxed in that other state.
Double Tax Agreements

- Article 7 – The profits of an enterprise are taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to that permanent establishment.

- Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.

- Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.

- Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.

- Article 14 – Employment income is normally taxable only in the state in which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in any 12-month period commencing or ending in the year of income or fiscal year; and
  (b) The remuneration is paid by or on behalf of an employer who is not a resident of the other state; and
  (c) The remuneration is not deductible in determining the profits of a permanent establishment which the employer has in the other state.

Articles 15, 17 and 18 override art 14.

- Article 15 – Directors’ fees and other similar remuneration derived by a resident of one state from a company resident in the other state may be taxed in that other state.

- Article 16 – Income derived by entertainers and sportspersons resident in one state from their personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person. This overrides arts 7 and 14.

- Article 17 – Pensions and similar remuneration (including government service pensions and social security payments) are taxable only in the state in which the recipient is resident. This applies regardless of whether the pension is paid in consideration of past employment.

- Article 20 – Types of income, wherever arising, not covered by previous articles are taxable only in the state in which the recipient is resident. However, if the income is derived from sources in the other state, it may also be taxed in that other state.

310.70 Denmark

The Double Taxation Relief (Denmark) Order 1981 was signed on 10 October 1980 and came into force on 22 June 1981. In New Zealand it applies from 1 April 1981. In Denmark it applies from 1 January 1981. The first protocol to the agreement was signed, and came into force, on the same dates as the main agreement. The second protocol to the 1980 agreement was signed on 12 March 1985 and came into force on 22 July 1985. In New Zealand it applies from 1 April 1986. In Denmark it applies from 1 January 1986.

The main provisions of the agreement are:

- Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.

- Article 7 – The profits of an enterprise are taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to that permanent establishment.
Double Tax Agreements

• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.

• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.

• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.

• Article 14 – Income derived by an individual from professional services or other activities of an independent character is normally taxable only in the state in which the individual is resident. However, income from such services is taxable in the other state if the services are performed in that other state and:
  (a) The individual is present in the other state for more than 183 days in the income year for the purpose of performing those activities; or
  (b) The individual has a fixed base regularly available in the other state for the purpose of performing those activities.

In this case, income from services performed in the other state is taxable in that other state, but only to the extent that the income is attributable to activities connected with that fixed base or performed during the periods of presence in the other state.

• Article 15 – Employment income is taxable only in the state of which the employee is a resident. However, if employment is exercised in the other state, that other state may tax the income derived from that other state. Income from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The employee is present in the other state for 183 days or less in the income year concerned; and
  (b) The remuneration is paid by or on behalf of an employer who is not resident in the other state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base the employer has in the other state.

• Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 17 – Income derived by resident of one state from their personal activities as an entertainer or athlete in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.

• Article 18 – Pensions and other similar remuneration paid in consideration of past employment are taxable only in the state in which the recipient is a resident. However, pensions and other payments made under the social security legislation of a state may be taxed in that state.

310.75 Fiji


The main provisions of the agreement are:

• Article 6 – Industrial or commercial profits of an enterprise are normally taxable only in the state in which the enterprise is a resident. However, if the enterprise carries on trade or business through a permanent establishment situated in the other state, that other state may tax the whole of the profits of the enterprise from sources within that state, whether or not attributable to the permanent establishment.
Double Tax Agreements

• Article 9 – Dividends paid by a company resident in one state to a resident of the other state may be
taxed in that other state. Such dividends may also be taxed in the state in which the company is resident,
but that tax is limited to 15 per cent of the gross dividend.

• Article 10 – Interest derived from sources in one state by a resident of the other state may be taxed in
that other state. Such interest may also be taxed in the state from which it was derived, but that tax is
limited to 10 per cent of the gross interest.

• Article 11 – Royalties derived from sources in one state by a resident of the other state may be taxed
in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is
limited to 15 per cent of the gross royalty.

• Article 12 – Remuneration or income derived by an individual from personal (including professional)
services is normally taxable only in the state in which the individual is resident. If the services are
performed in the other state, the income that is derived in that other state is taxable there. However,
income derived by a resident of one state from employment exercised in the other state is exempt from
tax in that other state if:
  (a) The recipient is present in the other state for no more than 183 days in the income year;
  (b) The remuneration is paid by an employer who is not a resident of the other state;
  (c) The remuneration is not borne by a permanent establishment which the employer has in the
      other state; and
  (d) The remuneration is subject to tax in the employee’s state of residence.

• Article 13 – Directors’ fees derived by a resident of one state from a company resident in the other
state may be taxed in that other state.

• Article 14 – Income derived by public entertainers and athletes from their personal activities may be
taxed in the state in which the activities are exercised. An enterprise of one state is deemed to have a
permanent establishment in the other state and to carry on trade or business through that permanent
establishment if it provides the services of a public entertainer or athlete in that other state (in which
case art 6 would apply).

310.80   Finland

The Double Taxation Relief (Finland) Order 1984 was signed on 12 March 1982 and came into force from
22 September 1984. In New Zealand it applies from 1 April 1985. In Finland it applies from 1 January 1985
for income subject to withholding tax from. For all other taxes it applies from 1 January 1985. The Second
Protocol to the 1982 Agreement was signed on 5 December 1986 and came into force 25 November 1988.
In New Zealand it applies from 1 April 1989. In Finland it applies from 1 January 1989 for income subject
to withholding tax. For all other taxes it applies from 1 January 1989.

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from real property (including income from
agriculture or forestry) situated in the other state may be taxed in that other state.

• Article 7 – The profits of an enterprise are taxable only in the state in which the enterprise is resident.
However, if the enterprise carries on business through a permanent establishment situated in the other
state, that other state may tax the profits attributable to the permanent establishment.

• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be
taxed in that other state. Such dividends may also be taxed in the state in which the company is resident,
but that tax is limited to 15 per cent of the gross dividend.

• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that
other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per
cent of the gross interest.

• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that
other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to
10 per cent of the gross royalty.
• Article 14 – Income derived by a resident from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the resident performs activities from a fixed base in the other state, the income from those activities that is attributable to that fixed base may be taxed in the other state.

• Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in the fiscal year or taxable period;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base that the employer has in the other state.

• Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 17 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.

• Article 18 – Pensions paid in consideration of past employment are taxable only in the state of which the recipient is a resident. Pensions paid under social security legislation may be taxed in the state in which the pension is paid.

310.85 France
The Double Taxation Relief (French Republic) Order 1981 was signed on 30 November 1979 and came into force from 19 March 1981. In New Zealand it applies from 1 April 1982. In France it applies from 1 January 1982.

The main provisions of the agreement are:
• Article 6 – Income derived by a resident of one state from real property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.

• Article 7 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.

• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.

• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.

• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.

• Article 14 – Income derived by a resident from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the resident performs activities from a fixed base in the other state, the income from those activities that is attributable to that fixed base may be taxed in the other state.

• Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in the fiscal year;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
(c) The remuneration is not borne by a permanent establishment or fixed base that the employer has in the other state.

- Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.
- Article 17 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.
- Article 18 – Pensions paid in consideration of past employment are taxable only in the state of which the recipient is a resident. Pensions paid under social security legislation may be taxed in the state in which the pension is paid.

**310.90 Germany**

The Double Taxation Relief (Federal Republic of Germany) Order 1980 was signed on 20 October 1978 and came into force from 21 December 1980. In New Zealand it applies from 1 April 1978. In Germany it applies from 1 January 1978 for income subject to withholding tax. For all other taxes it applies from 1 January 1978.

The main provisions of the agreement are:

- Article 6 – Income derived by a resident of one state from real property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.
- Article 7 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.
- Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
- Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.
- Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.
- Article 14 – Income derived by a resident from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the resident performs activities from a fixed base in the other state, the income from those activities that is attributable to that fixed base may be taxed in the other state.
- Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  
  (a) The recipient is present in the other state for 183 days or less in the fiscal year;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base that the employer has in the other state.
- Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.
- Article 17 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.
- Article 18 – Pensions paid in consideration of past employment are taxable only in the state of which the recipient is a resident. Social security pensions may be taxed only in the state in which the pension is paid.
Double Tax Agreements

310.92 Hong Kong

The Double Tax Agreements (Hong Kong) Order 2011 was signed on 1 December 2010 and came into force on 9 November 2011. In New Zealand it applies for withholding taxes from 1 April 2012, and for other provisions generally for income years beginning 1 April 2012. In Hong Kong it applies generally for years of assessment beginning 1 April 2012.

The agreement is between the Government of New Zealand and the Hong Kong Special Administrative Region of the People’s Republic of China. For convenience, the word “state” is used in the following commentary to refer to the parties to the agreement.

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture, forestry or fishing) situated in the other state may be taxed in that other state.

• Article 7 – The profits of an enterprise are usually taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to that permanent establishment.

• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is usually limited to 15 per cent of the gross dividend. If the beneficial owner of the dividends is a company which holds at least 10 per cent of the voting power of the company paying the dividend, the tax is limited to five per cent of the gross dividend.

• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arises, but that tax is limited to 10 per cent of the gross interest.

• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arise, but that tax is limited to five per cent of the gross royalty.

• Article 14 – Employment income is usually taxed only in the state of which the employee is a resident. If the employment is exercised in the other state (for example, a New Zealand resident working in Hong Kong), that other state may tax the remuneration derived from that other state. However, remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  
  (a) The recipient is present in the other state for a total of 183 days or less in any 12-month period commencing or ending in the year of assessment or income year concerned; and
  
  (b) The remuneration is paid by or on behalf of an employer who is not a resident of the other state; and
  
  (c) The remuneration is neither borne by nor deductible in determining the profits attributable to a permanent establishment which the employer has in the other state.

• Article 15 – Directors’ fees and other similar payments derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 16 – Income derived by entertainers and sportspersons resident in one state from their personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person. These provisions override Articles 7 and 14.

• Article 17 – Pensions and other similar remuneration paid in consideration of past employment or self-employment are taxable only in the state of which the recipient is a resident. However, lump sums paid under a mandatory provident fund scheme are taxable only in the Hong Kong Special Administrative Region.
• Article 20 – Types of income not covered by previous articles, wherever arising, may be taxed in the state in which the recipient is resident. If the income is derived from sources in the other state, it may also be taxed in that other state.

310.95 India

The Double Taxation Relief (India) Order 1986 was signed on 17 October 1986 and came into force from 3 December 1986. In New Zealand it applies from 1 April 1987. In India it applies from any “previous year” beginning 1 April 1987. The Second Protocol to the 1986 Agreement was signed 21 June 1999 and came into force on 17 December 1999. In New Zealand it applies from 1 April 2000. In India it applies for any “previous year” (as defined in the Income Tax Act 1961) from 1 April 2000.

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.

• Article 7 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to:
  (a) The permanent establishment, or
  (b) The sales in that other state of items similar to those sold through the permanent establishment.

• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.

• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.

• Article 12 – Royalties and fees for technical services arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties and fees may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty or fee.

• Article 14 – Income derived by an individual from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, such income may be taxed in the other state if:
  (a) The individual has a fixed base in the other state and the income is attributable to that fixed base, or
  (b) The individual’s stay in the other state exceeds 183 days in any 12-month period and the income is derived from activities performed in that other state.

• Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in a 12-month period;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base that the employer has in the other state.

• Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 17 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.

• Article 18 – Pensions and annuities paid in consideration of past employment are taxable only in the state of which the recipient is a resident.
310.100 Indonesia


The main provisions of the agreement are:

- Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.
- Article 7 – The profits of an enterprise are taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.
- Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
- Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.
- Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 15 per cent of the gross royalty.
- Article 14 – Income derived by an individual from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the services are performed in the other state the income may be taxed in that other state if:
  (a) The individual is present in the other state for more than 90 days in any 12-month period, or
  (b) The individual has a fixed base in that other state.
- Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in a 12-month period;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base that the employer has in the other state.
- Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.
- Article 17 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.
- Article 18 – Pensions paid in consideration of past employment and annuities are taxable only in the state of which the recipient is a resident. However, pensions and other payments made under the social security legislation of a state may be taxed in that state.

310.105 Ireland


The main provisions of the agreement are:

- Article 8 – Income derived by a resident of one state from immovable property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.
Double Tax Agreements

• Article 9 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.

• Article 12 – Dividends paid by a company resident in New Zealand to a resident of Ireland may be taxed in Ireland. Such dividends may also be taxed in New Zealand, but that tax is limited to 15 per cent of the gross dividend. Dividends derived from a company resident in Ireland by a resident of New Zealand may be taxed in New Zealand. Where a resident of New Zealand is entitled to an Irish tax credit in respect of such a dividend, tax may also be charged in Ireland on the total of the amount of the dividend and the amount of that tax credit at a rate not exceeding 15 per cent. Otherwise, dividends derived from a company resident in Ireland by a resident of New Zealand are exempt from tax in Ireland.

• Article 13 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.

• Article 14 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.

• Article 16 – Income derived by an individual from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the services are performed in the other state the income may be taxed in that other state if:
  (a) The individual is present in the other state for more than 183 days in any 12-month period, or
  (b) The individual has a fixed base in that other state.

• Article 17 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in a 12-month period;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base that the employer has in the other state.

• Article 18 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 19 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.

• Article 20 – Pensions paid in consideration of past employment and annuities are taxable only in the state of which the recipient is a resident. However, pensions and other payments made under the social security legislation of a state may be taxed in that state.

310.110 Italy

The Double Taxation Relief (Italy) Order 1983 was signed on 6 December 1979 and came into force from 23 March 1983. In New Zealand it applies from 1 April 1978. In Italy it applies from 1 January 1978.

The main provisions of the agreement are:

• Article 6 – Income from real property (including income from agriculture or forestry) may be taxed in the state in which the property is situated.

• Article 7 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.

• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.

• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.

• Article 14 – Income derived by a resident from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if that resident has a fixed base in the other state, the income that is attributable to that fixed base may be taxed in that other state.

• Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in a fiscal year;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base which the employer has in the other state.

• Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 17 – Income derived by entertainers and athletes from their personal activities may be taxed in the state in which those activities are exercised. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.

• Article 18 – Pensions paid in consideration of past employment are taxable only in the state of which the recipient is a resident.

310.115 Japan

The Double Taxation Relief (Japan) Order 1963 was signed on 30 January 1963 and came into force from 19 April 1963. In New Zealand it applies from 1 April 1963. In Japan it applies from 1 January 1963.

The main provisions of the agreement are:

• Article 3 – The industrial or commercial profits (excluding profits derived from the operation of ships or aircraft) of an enterprise of one state are not taxable in the other state except to the extent that the profits are attributable to a trade or business carried on through a permanent establishment situated in the other state.

• Article 6 – The rate of tax imposed by a state on dividends derived from sources within that state by a resident of the other state must not exceed 15 per cent unless such dividends arise in connection with a trade or business carried on by that resident through a permanent establishment situated in the first state.

• Article 7 – Income derived from real property in one state by a resident of the other state is taxable in accordance with the laws of the state in which the real property is situated. This applies also to royalties and other payments made in relation to mines or quarries or the extraction or removal of timber or other natural resources.

• Article 9 – Pensions derived from sources within one state by an individual resident in the other state and subject to tax in that other state are exempt from tax in the state from which the pension was derived. Pensions paid to individuals for services rendered to the Government of Japan are exempt from New Zealand tax.

• Article 10 – An individual resident in one state is exempt from tax in the other state on remuneration for personal (including professional) services performed in that other state in any income year if:
  (a) The individual is present in that other state for no more than 183 days during that year;
(b) The services are performed for or on behalf of a resident of the state of which the individual is resident; and
(c) The remuneration is taxable in the state in which the individual is resident.

310.120 Korea

The Double Taxation Relief (Republic of Korea) Order 1983 was signed on 6 October 1981 and came into force from 22 April 1983. In New Zealand it applies from 1 April 1981. In Korea it applies from 1 January 1981 for income subject to withholding tax. For all other taxes it applies from 1 January 1981. The Second Protocol to the 1981 Agreement was signed on 14 July 1997 and came into force on 10 October 1997.

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.
• Article 7 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.
• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.
• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.
• Article 14 – Income derived by an individual from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the services are performed in the other state the income may be taxed in that other state but only to the extent that the income is attributable to a fixed base the individual has in that other state.
• Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in a fiscal year;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base that the employer has in the other state.
• Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.
• Article 17 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.
• Article 18 – Pensions paid in consideration of past employment and annuities are taxable only in the state of which the recipient is a resident.

310.125 Malaysia

The Double Taxation Relief (Malaysia) Order 1976 was signed on 19 March 1976 and came into force from 2 September 1976. In New Zealand it applies from 1 April 1974. In Malaysia it applies from 1 January 1975. The Second Protocol to the 1976 Agreement was signed on 14 July 1994 and came into force on 1 July 1996.

The main provisions of the agreement are:
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- Article 5 – The industrial or commercial profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, tax may be imposed by that other state on the whole of the industrial or commercial profits of the enterprise from sources within that other state, whether or not those profits are attributable to the permanent establishment.

- Article 8 – The New Zealand tax on dividends paid by a company resident in New Zealand to a resident of Malaysia may not exceed 15 per cent of the gross dividend. Dividends paid by a company resident in Malaysia to a New Zealand resident are exempt from any withholding tax in Malaysia. If Malaysian tax law changes after the date of signing the DTA, to introduce a tax on dividends, the tax on dividends paid to New Zealand residents is limited to 15 per cent of the gross dividend.

- Article 9 – The tax on interest derived from sources in one state by a resident of the other state is limited to 15 per cent of the gross interest.

- Article 10 – The tax on royalties derived from sources in one state by a resident of the other state is limited to 15 per cent of the gross royalties. Approved industrial royalties derived from sources in Malaysia by a New Zealand resident are exempt from Malaysian tax.

- Article 11 – Remuneration (excluding pensions) for personal (including professional) services is normally taxable only in the state of which the employee is a resident. If the services are performed in the other state, the remuneration derived from those services may be taxed in that other state. However, remuneration derived by a resident of one state from personal services performed in the other state is exempt from tax in that other state if:
  (a) The recipient is present in the other state for 183 days or less (in total) in the income year;
  (b) The remuneration is paid by a person who is a resident of the first-mentioned state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base which that person has in the other state.

- Article 12 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

- Article 13 – Income derived by public entertainers and athletes from personal activities may be taxed in the state in which the activities are exercised. This does not apply to a visit that is funded by the government of the state in which the entertainer or athlete is resident.

- Article 17 – Where a person is a tax resident under both New Zealand and Malaysian law, but is treated as resident of only one of those states by the DTA [under art 3], the person is exempt from tax in the other state on income than income derived from sources in that state.

Mexico

The Double Taxation Relief (Mexico) Order 2006 was signed on 16 November 2006 and came into force on 19 April 2007. The agreement entered into force on 16 June 2007. In New Zealand it applies for withholding taxes from 1 August 2007. For all other taxes it applies for income years beginning on or after 1 April 2008. In Mexico it applies for withholding taxes from 1 August 2007. For all other taxes it applies generally from 1 January 2008.

The main provisions of the agreement are:

- Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture, forestry or fishing) situated in the other state may be taxed in that other state.

- Article 7 – The profits of an enterprise are taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to:
  (a) That permanent establishment, or
  (b) Sales of goods or merchandise in that other state of the same or similar kind to goods and merchandise sold through the permanent establishment.

- Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident,
but that tax is limited to either five per cent of the gross dividend or zero, depending on the size of the investor’s shareholding in the company. Before 1 May 2010, the rate was 15 per cent.

- Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.
- Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.
- Article 14 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in any 12-month period commencing or ending in the year of income or the fiscal year concerned; and
  (b) The remuneration is paid by or on behalf of an employer who is not a resident of the other state; and
  (c) The remuneration is not deductible in determining the taxable profits of a permanent establishment which the employer has in the other state.
- Article 15 – Directors’ fees and other similar payments derived by a resident of one state (and, in the case of Mexico, in that person’s capacity as an “administrador” or “comisario” of a company) from a company resident in the other state may be taxed in that other state.
- Article 16 – Income derived by entertainers and sportspersons resident in one state from their personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.
- Article 17 – Pensions (including government service pensions) and annuities are taxable only in the state of which the recipient is a resident. Pensions and other payments made under the social security legislation of one state to a resident of the other state are taxable only in that other state.
- Article 20 – Items of income not covered by previous articles, wherever arising, may be taxed in the state in which the recipient is resident. If the income is derived from sources in the other state, it may also be taxed in that other state.

310.130 Netherlands


The main provisions of the agreement are:

- Article 6 – Income derived by a resident of one state from real property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.
- Article 7 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.
- Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
- Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.
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- Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.
- Article 14 – Income derived by an individual from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the services are performed in the other state from a fixed base there, the income attributable to that fixed base may be taxed in that other state.
- Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in the fiscal year;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base which the employer has in the other state.
- Article 16 – Directors’ fees or similar derived by a resident of one state from a company resident in the other state may be taxed in that other state.
- Article 17 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.
- Article 18 – Pensions paid in consideration of past employment and annuities are taxable only in the state of which the recipient is a resident.

On 1 March 2007, the New Zealand and Netherland governments signed an agreement for the exchange of information with respect to taxes between the two countries to facilitate the administration and enforcement of each country’s tax laws. Such information may relate to the determination, assessment and collection of taxes, the recovery and enforcement of tax claims, or the investigation or prosecution of tax matters. The agreement applies only to the Netherlands Antilles (a small group of islands in the Caribbean Sea, off the coast of Venezuela), not to the Netherlands as a whole. The agreement came into force on 2 October 2008 under the Tax Information Exchange (Netherlands Antilles) Order 2008, and has effect from 1 January 2009.

The tax treatment of Netherlands social security pension payments received by New Zealand residents is explained in 760.80.

310.135 Norway

The Double Taxation Relief (Norway) Order 1983 was signed on 20 April 1982 and came into force from 31 March 1983. In New Zealand it applies from 1 April 1982. In Norway it applies from 1 January 1982. An Exchange of Notes Pursuant to paragraph (c) of the Protocol to the 1982 Agreement was signed on 16 June 1998 and came into force from 16 July 1998. In Norway, paragraph (c) of the Protocol to the 1982 Agreement applies from 1 January 1999.

The main provisions of the agreement are:
- Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.
- Article 7 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.
- Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
- Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.
• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.

• Article 14 – Income derived from professional services or other independent activities is normally taxable only in the state in which the recipient is resident. However, if the recipient has a fixed base in the other state, that other state may tax the income attributable to that fixed base. If the recipient is present in the other state for more than 183 days during any fiscal year and the preceding and succeeding fiscal years, the income may be taxed in that other state.

• Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in any fiscal year and the preceding and succeeding fiscal years; and
  (b) The remuneration is paid by an employer who is resident in the same state as the employee; and
  (c) The remuneration is not connected with a permanent establishment or fixed base that the employer has in the other state.

• Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 17 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.

• Article 18 – Pensions (including government pensions and social security payments) and annuities are taxable only in the state of which the recipient is a resident.

310.140 Philippines

The Double Taxation Relief (Republic of the Philippines) Order 1980 was signed on 29 April 1980 and came into force from 14 May 1981. In New Zealand it applies from 1 April 1981. In the Philippines it applies from 1 January 1981 for income subject to withholding tax. For all other taxes it applies from 1 January 1981. The Second Protocol to the 1980 Agreement was signed on 21 February 2002 and came into force on 2 October 2008. It is effective from 1 December 2008.

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.

• Article 7 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.

• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.

• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.

• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 15 per cent of the gross royalty.

• Article 14 – Income derived by an individual from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the services are performed in the other state the income may be taxed in that other state if:
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(a) The individual is present in the other state for more than 183 days in an income year, or
(b) The individual has a fixed base in that other state.
Only income that is attributable to the period of presence or to the fixed base may be taxed in that other state.

- Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. However, remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in the income or fiscal year;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not deductible in determining the taxable profits of a permanent establishment or fixed base which the employer has in the other state.

- Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

- Article 17 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.

- Article 18 – Pensions and annuities paid in consideration of past employment are taxable only in the state of which the recipient is a resident. However, social security pensions paid by a state are taxable only in that state.

Poland

The Double Taxation Relief (Poland) Order 2006 was signed on 21 April 2005 and came into force on 16 August 2006. In New Zealand it applies for withholding taxes from 1 January 2007. For all other taxes it applies for income years beginning on or after 1 April 2007. In Poland it applies for all taxes generally from 1 January 2007.

The main provisions of the agreement are:

- Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture, forestry or fishing) situated in the other state may be taxed in that other state.
- Article 7 – The profits of an enterprise are taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to that permanent establishment.
- Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
- Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.
- Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.
- Article 14 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in any 12-month period commencing or ending in the year of income concerned; and
  (b) The remuneration is paid by or on behalf of an employer who is not a resident of the other state; and
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(c) The remuneration is not deductible in determining the taxable profits of a permanent establishment which the employer has in the other state.

• Article 15 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.
• Article 16 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.
• Article 17 – Pensions paid in consideration of past employment are taxable only in the state of which the recipient is a resident. Pensions paid under the social security legislation of one state to a resident of the other state are taxable only in that other state. Alimony and maintenance payments are taxable only in the state in which the payment arises.
• Article 20 – Types of income not covered by previous articles are taxable only in the state of which the recipient is resident. However, if the income is derived from the other state, the income may also be taxed in that other state.

310.150 Russia

The Double Taxation Relief (Russian Federation) Order 2001 was signed on 5 September 2000 and came into force from 4 July 2003. In New Zealand it applies from 1 January 2004 for withholding taxes on income. For all other taxes it applies from 1 April 2004. In Russia it applies from 1 January 2004 for all taxes.

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from real property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.
• Article 7 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.
• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.
• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.
• Article 14 – Income derived by an individual from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the services are performed in the other state the income may be taxed in that other state if:
  (a) The individual has a fixed base in that other state; or
  (b) The individual is present in the other state for more than 183 days in any 12-month period commencing or ending in the fiscal year.

Only income that is attributable to the period of presence or to the fixed base may be taxed in that other state.
• Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in any 12-month period commencing or ending in the fiscal year;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
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• Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 17 – Income derived by entertainers or sportspersons from their personal activities as such may be taxed in the state in which the activities are exercised. This applies whether the income from such activities accrues to the entertainer or sportsperson personally or to another person.

• Article 18 – Pensions, other than government pensions, and annuities paid to a resident of a state are taxable only in that state. Pensions paid by the government of a state may be taxed in that state. However, 50 per cent of the amount of government pensions may also be taxed in the other state.

310.155 Singapore

The Double Taxation Relief (Singapore) Order 1973 was signed on 21 August 1973 and came into force from 1 December 1973. In New Zealand it applies from 1 April 1973. In Singapore it applies from 1 January 1974. The Second Protocol to the 1973 Agreement was signed on 1 July 1993 and came into force from 10 September 1993. The Third Protocol to the 1973 Agreement was signed on 5 September 2005 and came into force on 17 August 2006. The main provisions of the agreement are:

• Article 5 – Industrial or commercial profits are taxable only in the state in which the enterprise is resident. However, if the enterprise carries on trade or business through a permanent establishment situated in the other state, that other state may tax all of the profits of the enterprise from sources within that other state, whether or not those profits are attributable to the permanent establishment.

• Article 8 – The New Zealand tax on dividends paid by a company resident in New Zealand to a Singapore resident is limited to 15 per cent of the gross dividend. Dividends paid by a company resident in Singapore to a New Zealand resident are exempt from tax (because at the date of signing the DTA Singapore did not tax domestic dividends). If Singapore subsequently introduces a tax on dividends, the amount of tax is limited to 15 per cent of the gross dividend paid to a New Zealand resident.

• Article 9 – The tax that one state may impose on interest derived from sources in that state by a resident of the other state is limited to 15 per cent of the gross interest. This restriction does not apply if the person deriving the interest has a permanent establishment in the other state and the interest is connected with that permanent establishment.

• Article 10 – The tax that one state may impose on royalties derived from sources in that state by a resident of the other state is limited to 15 per cent of the gross royalty.

• Article 11 – Income derived by a resident individual from professional services or other activities of an independent character is normally taxable only in the state of which the person is resident. If the individual has a fixed base in the other state, the income from independent professional services attributable to that fixed base may be taxed in the other state. If the individual is present in the other state for more than 183 days in any 12-month period, income from independent professional services performed in that other state may be taxed in that state.

• Article 11A – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in any 12-month period;
  (b) The remuneration is paid by, or on behalf of, a person who is not a resident of the other state; and
  (c) The remuneration is not borne by or deductible in determining the taxable profits of a permanent establishment or fixed base which the employer has in the other state.

• Article 12 – Directors’ fees derived by a resident of one state in their capacity as a member of the board of directors of a company resident in the other state may be taxed in that other state.

• Article 13 – Income derived by public entertainers and athletes from their personal activities may be taxed in the state in which those activities are exercised. An enterprise of one state that provides the
services of a public entertainer or athlete in the other state is deemed to have a permanent establishment in that other state.

(1) 2010 agreement

The Double Tax Agreements (Singapore) Order 2010 was signed on 21 August 2009 and came into force on 12 August 2010. In New Zealand it applies to withholding taxes from 1 October 2010 and, for other provisions, to income years beginning on or after 1 April 2011. In Singapore it applies in respect of tax chargeable for any year of assessment beginning on or after 1 January 2012. As income tax is assessed on a preceding year basis in Singapore, this means that the DTA will apply in Singapore to income earned during calendar years beginning on or after 1 January 2011. For withholding taxes, it will apply from 1 January 2011. The main provisions of the agreement are:

- Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture, forestry and fishing) situated in the other state may be taxed in that other state. “Immovable property” has the meaning according to the law of the state in which the property is situated but specifically includes, for example, natural resources, property accessory to immovable property, livestock and equipment used in agriculture and forestry, and the right to explore for or exploit natural resources or standing timber.

- Article 7 – The profits of an enterprise are normally taxable only in the state in which the person carrying on the enterprise is resident. However, if the enterprise carries on a business through a permanent establishment situated in the other state, the profits of the enterprise that are attributable to that permanent establishment may be taxed in that other state. Where profits include items of income dealt with in other articles of the agreement, the provisions of those other articles take precedence.

- Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to:
  - Five per cent of the gross dividend if the beneficial owner is a company that owns directly at least 10 per cent of the voting power of the company paying the dividend;
  - Fifteen per cent in all other cases.

- Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that state. Such interest may also be taxed in the state in which it arises, but that tax is limited to 10 per cent of the gross interest. Interest arising in one state and paid to the government of the other state is exempt from tax in the state the interest arose.

- Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to five per cent of the gross royalties.

- Article 14 – Employment income is normally taxable only in the state of which the employee is a resident. If the employment is exercised in the other state, that other state may tax the remuneration derived from that other state. However, remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for a total of 183 days or less in any 12-month period;
  (b) The remuneration is paid by, or on behalf of, an employer who is not a resident of the other state; and
  (c) The remuneration is not borne by or deductible in determining the taxable profits of a permanent establishment which the employer has in the other state.

Article 14 is overridden by arts 15 (directors’ fees), 17 (pensions) and 18 (government service).

- Article 15 – Directors’ fees and other similar payments derived by a resident of one state in their capacity as a member of the board of directors of a company resident in the other state may be taxed in that state.
• Article 16 – Income derived by an entertainer or sportsperson who is resident of one state, from that person’s personal activities as an entertainer or sportsperson in the other state, may be taxed in that other state. This applies whether the income accrues to the entertainer or sportsperson personally, or to another person. “Entertainer” includes theatre, motion picture, radio and television artistes, and musicians. Article 16 overrides arts 7 (business profits) 14 and (employment income).

• Article 17 – Pensions and other similar remuneration paid to a resident of one state in consideration of past employment are taxable only in that state. This does not apply to certain government pensions. Pensions and other payments made under the social security legislation of one state to a resident of the other state are taxable only in that other state.

• Article 19 – Payments made to a student or business apprentice who is visiting one state are not taxable in that state if:
   (a) Immediately before visiting that state, the student or business apprentice was a resident of the other state;
   (b) The student or business apprentice is present in the first-mentioned state solely for the purpose of their education or training; and
   (c) The payments are received for the purpose of their maintenance, education or training.

• Article 23 – The agreement authorises and requires the competent authorities (the CIR, in the case of New Zealand, and the Minister for Finance, in the case of Singapore) to exchange information that is relevant for:
   (a) Carrying out the provisions of the agreement; or
   (b) Administering or enforcing the domestic tax laws of either state.

310.160 South Africa

The Double Taxation Relief (South Africa) Order 2004 was signed on 18 February 2002 and came into force from 23 July 2004. In New Zealand it applies from 1 September 2004 for withholding taxes. For all other taxes from 1 April 2005. In South Africa it applies for withholding taxes from 1 September 2004. For all other taxes it applies from 1 January 2005.

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture, forestry or fishing) situated in the other state may be taxed in that other state.

• Article 7 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.

• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to:
   (a) Fifteen per cent of the gross dividend, in the case of New Zealand;
   (b) In the case of South Africa:
      (i) Five per cent of the gross dividend, if the recipient of the dividend is a company that owns 25 per cent or more of the company paying the dividend; or
      (ii) Fifteen per cent of the gross dividend, in other cases.

• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.

• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.
Double Tax Agreements

• Article 14 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in a 12-month period;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not deductible in determining the taxable profits of a permanent establishment that the employer has in the other state.

• Article 15 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 16 – Income derived by entertainers and sportspersons resident in one state from their personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or sportsperson personally or to another person.

• Article 17 – Pensions and annuities are taxable only in the state of which the recipient is a resident.

310.165 Spain

The Double Taxation Relief (Spain) Order 2006 was signed on 28 July 2005 and came into force from 31 July 2006. In New Zealand it applies for withholding taxes from 1 September 2006. For all other taxes it applies for income years beginning on or after 1 April 2007. In Spain it applies, for all taxes, generally from 1 January 2007.

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.

• Article 7 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.

• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.

• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.

• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.

• Article 14 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in any 12-month period commencing or ending in the year of income;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not deductible in determining the taxable profits of a permanent establishment which the employer has in the other state.

• Article 15 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 16 – Income derived by entertainers and sportspersons resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or sportsperson personally or to another person.
Double Tax Agreements

310.170 Sweden
The Double Taxation Relief (Sweden) Order 1980 was signed on 21 February 1979 and came into force from 14 November 1980. In New Zealand it applies from 1 April 1981. In Sweden it applies from 1 January 1981.
The main provisions of the agreement are:

• Article 5 – The industrial or commercial profits of an enterprise of one state are normally exempt from tax in the other state. However, if the enterprise is engaged in trade or business in the other state, that other state may tax the profits of the enterprise that are directly or indirectly attributable to that permanent establishment.
• Article 8 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
• Article 9 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.
• Article 10 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.
• Article 11 – Income from real property may be taxed in the state in which the property is situated.
• Article 14 – Pensions and annuities are taxable only in the state in which the recipient is resident.
• Article 15 – Income derived by an individual from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the services are performed in the other state the income may be taxed in that other state if:
(a) The recipient is present in the other state for more than 183 days in the income year, or
(b) The recipient has a fixed base in that other state for more than 183 days in the income year.
• Article 16 – Employment income is taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
(a) The recipient is present in the other state for 183 days or less in the income year;
(b) The remuneration is paid by an employer who is not a resident of the other state; and
(c) The remuneration is not borne by a permanent establishment or fixed base that the employer has in the other state.
• Article 17 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.
• Article 18 – Income derived by public entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. Where such services are provided via an enterprise, the profits derived from those services by that enterprise may also be taxed in the other state.

310.175 Switzerland
The Double Taxation Relief (Switzerland) Order 1981 was signed on 6 June 1980 and came into force from 21 November 1981. In New Zealand it applies from 1 April 1981. In Switzerland it applies from 1 January 1981.
The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from real property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.
Double Tax Agreements

- Article 7 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.
- Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
- Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.
- Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.
- Article 14 – Income derived from professional services or other independent activities is taxable only in the state in which the recipient is resident unless the recipient has a fixed base in the other state. If the recipient has a fixed base in the other state, the income attributable to the fixed base may be taxed in the other state.
- Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in a fiscal year;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base that the employer has in the other state.
- Article 16 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.
- Article 17 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.
- Article 18 – Pensions paid in consideration of past employment and annuities are taxable only in the state of which the recipient is a resident.

Taiwan

The Double Taxation Relief (Taiwan) Order 1997 was signed on 11 November 1996 and came into force from 15 December 1997. In New Zealand it applies from 1 February 1998 for income subject to withholding tax. Income of aircraft operations applies from 1 January 1996. For all other taxes it applies 1 April 1998. In Taiwan it applies from 1 February 1998 for income subject to withholding tax. Income of aircraft operations applies from 1 January 1996. For all other taxes it applies from 1 January 1998.

The main provisions of the agreement are:
- Article 6 – Income derived by a resident of one territory from immovable property (including income from agriculture, forestry or fishing) situated in the other territory may be taxed in that other territory.
- Article 7 – The profits of an enterprise are normally taxable only in the territory in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other territory, that other territory may tax the profits attributable to the permanent establishment.
- Article 10 – Dividends paid by a company resident in one territory to a resident of the other territory may be taxed in that other territory. Such dividends may also be taxed in the territory in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
- Article 11 – Interest arising in one territory and paid to a resident of the other territory may be taxed in that other territory. Such interest may also be taxed in the territory in which it arose, but that tax is limited to 10 per cent of the gross interest.

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Article 12 – Royalties arising in one territory and paid to a resident of the other territory may be taxed in that other territory. Such royalties may also be taxed in the territory in which they arose, but that tax is limited to 10 per cent the gross royalty.

Article 14 – Income derived by an individual from professional services or other independent activities is normally taxable only in the territory in which the individual is resident. However, if the services are performed in the other territory the income may be taxed in that other territory if:
(a) The individual is present in the other territory for more than 183 days in any 12-month period commencing or ending in the income year, or
(b) The individual has a fixed base in that other territory.

Article 15 – Employment income is normally taxable only in the territory of which the employee is a resident. If employment is exercised in the other territory, that other territory may tax the remuneration derived from that other territory. Remuneration derived by a resident of one territory from employment exercised in the other territory is taxable only in the employee’s territory of residence if:
(a) The recipient is present in the other territory for 183 days or less in a 12-month period commencing or ending in the income year;
(b) The remuneration is paid by an employer who is not a resident of the other territory; and
(c) The remuneration is not borne by a permanent establishment or fixed base that the employer has in the other territory.

Article 16 – Directors’ fees derived by a resident of one territory from a company resident in the other territory may be taxed in that other territory.

Article 17 – Income derived by entertainers and sportspersons from their personal activities may be taxed in the territory in which those activities are exercised. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.

Article 18 – Pensions and annuities are taxable only in the territory of which the recipient is a resident.

Thailand

The Double Taxation Relief (Thailand) Order 1998 was signed on 22 October 1998 and came into force from 14 December 1998. In New Zealand it applies from 1 January 1999 for income subject to withholding tax. For all other taxes it applies from 1 April 1999. In Thailand it applies from 1 January 1999 for income subject to withholding tax. For all other taxes it applies from 1 January 1999.

The main provisions of the agreement are:

Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture, forestry or fishing) situated in the other state may be taxed in that other state.

Article 7 – The income or profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the income or profits attributable to that permanent establishment.

Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.

Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to:
(a) Ten per cent of the gross interest, if received by a financial institution;
(b) Ten per cent of the gross interest, if the interest relates to a sale of equipment, merchandise or services on credit (except where the parties are not dealing at arm’s length); or
(c) Fifteen per cent of the gross interest, in all other cases.

Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to
either 10 per cent or 15 per cent of the gross royalty, depending on the type of royalty (refer to the Article for details).

- Article 15 – Income derived by an individual from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the services are performed in the other state the income may be taxed in that other state if:
  (a) The individual is present in the other state for more than 183 days in any 12-month period commencing or ending in the income year; or
  (b) The individual has a fixed base in that other state.

Only income that is attributable to activities performed during such periods of presence or from that fixed base are taxable in the other state.

- Article 16 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in a 12-month period commencing or ending in the income year;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not deductible in determining the taxable profits of a permanent establishment or fixed base which the employer has in the other state.

- Article 17 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

- Article 18 – Income derived by entertainers and sportspersons from personal activities may be taxed in the state in which the activities are exercised. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person.

- Article 19 – Pensions and annuities are taxable only in the state of which the recipient is a resident.

### Turkey

The Double Taxation Agreements (Turkey) Order 2010 was signed on 22 April 2010 and came into force on 28 July 2011. In New Zealand it applies from 1 January 2012 for withholding taxes. For all other taxes it applies generally for income years beginning 1 April 2012. In Turkey it applies generally for taxable periods beginning 1 January 2012. The main provisions of the agreement are:

- Article 6 – Income derived by a resident of one state from immovable property (including income from agriculture, forestry and fishing) situated in the other state may be taxed in that other state. “Immovable property” has the meaning according to the law of the state in which the property is situated but specifically includes, for example, natural resources, property accessory to immovable property, livestock and equipment used in agriculture, forestry or fishing, and the right to explore for or exploit natural resources or standing timber.

- Article 7 – The profits of an enterprise are normally taxable only in the state in which the person carrying on the enterprise is resident. However, if the enterprise carries on a business through a permanent establishment situated in the other state, the profits of the enterprise that are attributable to that permanent establishment may be taxed in that other state. Where profits include items of income dealt with in other articles of the agreement, the provisions of those other articles take precedence.

- Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to:
  (a) Five per cent of the gross dividend if the beneficial owner is a company that owns directly at least 25 per cent of the voting power of the company paying the dividend, and the dividend is exempt from tax in the other state;
  (b) Fifteen per cent in all other cases.
Profits derived by a resident of New Zealand through a permanent establishment situated in Turkey may, after having been taxed under art 7, be taxed on the remaining amount of that profit in Turkey, but that tax is limited to:

(a) Five per cent of the remaining amount, provided that such profits are exempt from tax in New Zealand;

(b) Fifteen per cent of the remaining amount in all other cases.

• Article 11 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arises, but that tax is limited to:

(a) Ten per cent of the gross interest, if it is paid to a bank;

(b) Fifteen per cent in all other cases.

Interest arising in one state and paid to the government of the other state, or to the Central Bank of Turkey or the Reserve Bank of New Zealand, is exempt from tax in the state the interest arose.

• Article 12 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalties.

• Article 14 – Income derived by an individual from professional services or other activities of an independent character is normally taxable only in the state of which the individual is a resident. However, such income may also be taxed in the other state if the services or activities are performed in the other state and:

(a) The individual has a fixed base regularly available to them in that other state for the purpose of performing those services or activities; or

(b) The individual is present in the other state, for the purpose of performing those services or activities, for a total of 183 days or more in any continuous period of 12 months.

Income derived by an enterprise from professional services or other activities of a similar character is normally taxable only in the state in which the enterprise is resident. However, such income may also be taxed in the other state if the services or activities are performed in the other state and:

(a) The enterprise has a permanent establishment in that other state through which the services or activities are performed; or

(b) The period or periods during which the services or activities are performed exceed a total of 183 days in any continuous period of 12 months.

• Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If the employment is exercised in the other state, that other state may tax the remuneration derived from that other state. However, remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:

(a) The recipient is present in the other state for a total of 183 days or less in any 12-month period;

(b) The remuneration is paid by, or on behalf of, an employer who is not a resident of the other state; and

(c) The remuneration is not borne by or deductible in determining the profits attributable to a permanent establishment or fixed base which the employer has in the other state.

Article 15 is overridden by arts 16 (directors’ fees), 18 (pensions), 19 (government service) and 20 (students).

• Article 16 – Directors’ fees and other similar payments derived by a resident of one state in their capacity as a member of the board of directors of a company resident in the other state may be taxed in that other state.

• Article 17 – Income derived by an entertainer or sportsperson who is resident of one state, from that person’s personal activities as an entertainer or sportsperson in the other state, may be taxed in that other state. This applies whether the income accrues to the entertainer or sportsperson personally, or to another person. “Entertainer” includes theatre, motion picture, radio and television artistes, and
musicians. Article 17 overrides arts 7 (business profits), 14 (independent personal services) and 15 (employment income).

- Article 18 – Pensions (including government service pensions) and other similar remuneration (including life annuities) paid to a resident of one state in consideration of past employment are taxable only in that state. Pensions and other payments made under the social security legislation of one state to a resident of the other state are taxable only in that other state.

- Article 19 – Salaries, wages and other similar remuneration (excluding pensions) paid by the government of one state to an individual for services rendered to that government are taxable only in that state. However, such payments are taxable only in the other state if the services are rendered in the other state and the individual is a resident and national of that state, and did not become a resident of that state solely for the purpose of rendering the services. Article 19 is overridden by arts 15 (employment income), 16 (directors’ fees) and 17 (entertainers and sportspeople) in respect of payments for services rendered in connection with a business carried on by a government.

- Article 20 – Payments which a student or business apprentice, who is a national of one state and present in the other state solely for the purpose of their education or training, receives for their maintenance, education or training is not taxable in the other state, provided the payments arise from sources outside that state. Remuneration which a student or business apprentice, who is a national of one state, derives from employment exercised in the other state is not taxed in that other state provided:
  (a) The period or periods of employment do not exceed two years;
  (b) The employment is undertaken in order to obtain practical experience related to their education or training; and
  (c) The student was present in the other state solely for the purpose of exercising that employment.

- Article 25 – The agreement authorises and requires the competent authorities (the CIR, in the case of New Zealand, and the Minister for Finance, in the case of Turkey) to exchange information that is foreseeable relevant for:
  (a) Carrying out the provisions of the agreement; or
  (b) Administering or enforcing the domestic tax laws of either state.

### United Arab Emirates

The Double Taxation Relief (United Arab Emirates) Order 2004 was signed on 22 September 2003 and came into force from 29 July 2004. In New Zealand it applies from 1 September 2004 for withholding taxes. The article dealing with income from employment takes effect retrospectively from 27 October 2002. For all other taxes it applies from 1 April 2005. In the United Arab Emirates it applies from 1 September 2004 for withholding taxes. The article dealing with income from employment takes effect retrospectively from 27 October 2002. For all other taxes it applies from 1 January 2005.

The main provisions of the agreement are:

- Article 7 – Income derived by a resident of one state from immovable property (including income from agriculture, forestry or fishing) situated in the other state may be taxed in that other state.

- Article 8 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.

- Article 11 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.

- Article 12 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.

- Article 13 – Royalties arising in one state and paid to a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.
• Article 15 – Income derived by an individual from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the services are performed in the other state the income from those services may be taxed in that other state if:
  (a) The individual is present in the other state for more than 183 days in any 12-month period commencing or ending in the income year; or
  (b) The individual has a fixed base in that other state.

• Article 16 – Employment income is taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in a 12-month period commencing or ending in the income year; and
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not deductible in determining the taxable profits of a permanent establishment or fixed base which the employer has in the other state.

• Article 17 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 18 – Income derived by entertainers and sportspersons resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or sportsperson personally or to another person.

• Article 19 – Pensions, including government pensions and annuities, are taxable only in the state of which the recipient is a resident.

310.195 United Kingdom

The Double Taxation Relief (United Kingdom) Order 1984 was signed on 4 August 1983 and came into force from 16 March 1984. In New Zealand it applies from 1 April 1984. In the United Kingdom it applies from 6 April 1984 for income tax and capital gains tax. Corporation tax applies from 1 April 1984. Petroleum revenue tax applies from 1 January 1984. An Exchange of Notes in Relation to Article 27 of the 1983 Agreement was signed on 22 December 1983 and came into force on 22 December 1983. In New Zealand it applies from 1 April 1984. In the United Kingdom it applies from 1 April 1984 for income tax and capital gains tax. Corporation tax applies from 1 January 1984. Petroleum revenue tax applies from 1 January 1984. A Protocol to the 1983 Agreement was signed 4 November 2003 and came into force on 23 July 2004. In New Zealand it applies from 4 November 2003 for income and gains referred to in art 5 of the protocol. For all other taxes it applies from 1 April 2005. In the United Kingdom it applies from 4 November 2003 for income tax, capital gains tax and corporation tax on gains referred to in art 5 of the protocol. For all other taxes it applies from 6 April 2005. For corporation tax (not described in art 5 of the protocol) it applies from 1 April 2005 and 6 April 2006 for tax credits described in art 8.

The Second Protocol to the 1983 Agreement was signed on 7 November 2007 and came into force on 28 August 2008. The protocol amends art 25, allowing the two tax authorities to exchange information on taxes other than income tax, and introduces new art 25A, allowing the tax authorities to assist each other in the recovery of tax debt.

The main provisions of the agreement are:

• Article 7 – Income derived by a resident of one state from immovable property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.

• Article 8 – The profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the profits attributable to the permanent establishment.

• Article 11 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend.
• Article 12 – Interest arising in one state and paid to a resident of the other state may be taxed in that other state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest.

• Article 13 – Royalties arising in one state and derived by a resident of the other state may be taxed in that other state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty.

• Article 15 – Income derived by an individual from professional services or other independent activities is normally taxable only in the state in which the individual is resident. However, if the services are performed in the other state the income from those services may be taxed in that other state if:
  (a) The individual is present in the other state for more than 183 days in any 12-month period, or
  (b) The individual has a fixed base in that other state.

• Article 16 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in a 12-month period;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not borne by a permanent establishment or fixed base which the employer has in the other state.

• Article 17 – Directors’ fees derived by a resident of one state from a company resident in the other state may be taxed in that other state.

• Article 18 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person [see TES 27 (July 2005) 404].

• Article 19 – Pensions (including those paid under social security legislation) and similar remuneration for past employment or services, and annuities, are taxable only in the state of which the recipient is a resident.

310.200 United States

The Double Taxation Relief (United States of America) Order 1983 was signed on 23 July 1983 and came into force from 2 November 1983. In New Zealand it applies from 1 April 1984 for income subject to withholding tax. For all other taxes it applies from 1 April 1984. In the United States it applies from 1 January 1984 for income subject to withholding tax. For all other taxes it applies from 1 January 1983.

The second protocol to the 1982 agreement was signed on 1 December 2008 and came into force on 12 November 2010. In New Zealand it applies from 1 January 2011 for income subject to withholding tax. For all other provisions it applies for income years beginning on or after 1 January 2011. In the United States it applies from 1 January 2011 for income subject to withholding tax. For all other provisions, it applies to taxable periods beginning on or after 1 January 2011.

The main provisions of the agreement are:

• Article 6 – Income derived by a resident of one state from real property (including income from agriculture or forestry) situated in the other state may be taxed in that other state.

• Article 7 – The business profits of an enterprise are normally taxable only in the state in which the enterprise is resident. However, if the enterprise carries on business through a permanent establishment situated in the other state, that other state may tax the business profits attributable to the permanent establishment.

• Article 10 – Dividends paid by a company resident in one state to a resident of the other state may be taxed in that other state. Such dividends may also be taxed in the state in which the company is resident, but that tax is limited to 15 per cent of the gross dividend. From 1 January 2011, tax on dividends is limited to:
Double Tax Agreements

(a) Five per cent of the gross dividend, if the beneficial owner is a company that owns at least 10 per cent of the voting power of the company paying the dividend;
(b) Fifteen per cent of the gross dividend, in all other cases.

From 1 January 2011, subject to certain conditions, no tax may be deducted from dividends if the beneficial owner of the dividends is a company (resident in the other state) that has owned, directly or indirectly, shares representing 80 per cent or more of the voting power of the company paying the dividend for at least 12 months prior to the date the dividend was paid.

- Article 11 – Interest derived by a resident of a state may be taxed in that state. Such interest may also be taxed in the state in which it arose, but that tax is limited to 10 per cent of the gross interest. Interest payable to the government of the other state, or to an instrumentality of the government of the other state that is not subject to tax, is exempt from tax altogether.
- Article 12 – Royalties derived by a resident of a state may be taxed in that state. Such royalties may also be taxed in the state in which they arose, but that tax is limited to 10 per cent of the gross royalty. From 1 January 2011, tax on royalties is limited to five per cent.
- Article 14 – Income derived by an individual from the performance of independent personal services is normally taxable only in the state in which the individual is resident. However, if the services are performed in the other state the income from those services may be taxed in that other state if:
  (a) The individual is present in the other state for more than 183 days in any 12-month period, or
  (b) The individual has a fixed base in that other state.

Note: From 1 April 2011, art 14 no longer applies.

- Article 15 – Employment income is normally taxable only in the state of which the employee is a resident. If employment is exercised in the other state, that other state may tax the remuneration derived from that other state. Remuneration derived by a resident of one state from employment exercised in the other state is taxable only in the employee’s state of residence if:
  (a) The recipient is present in the other state for 183 days or less in a 12-month period;
  (b) The remuneration is paid by an employer who is not a resident of the other state; and
  (c) The remuneration is not borne by a permanent establishment which the employer has in the other state.
- Article 17 – Income derived by entertainers and athletes resident in one state from personal activities exercised in the other state may be taxed in that other state, unless the gross receipts derived do not exceed US$10,000 for the income year. This applies whether the income from such activities accrues to the entertainer or athlete personally or to another person (although there is an exclusion if the entertainer or athlete does not benefit personally).
- Article 18 – Pensions derived in consideration of past employment are taxable only in the state of which the recipient is a resident. However, pensions paid under the social security legislation of a state to a resident of the other state or a citizen of the United States may be taxed only in the state from which the payment originated. Annuities are taxable only in the state of which the recipient is a resident.

310.210 Fiscally transparent entities

The United States and New Zealand agreed in February 2005 to allow fiscally transparent entities owned by United States and New Zealand residents to benefit from the DTA. A fiscally transparent entity is an entity that is disregarded for tax purposes, with tax being imposed directly on the owners or shareholders, as happens with a partnership.

Prior to this agreement, entities (such as United States limited partnerships and limited liability companies) that were treated as fiscally transparent in the country they were established in were not treated as fiscally transparent in the other country. This meant that the income of these entities was treated as derived by the entity itself and not by the owners, and the owners were not obtaining the benefits of the DTA.

Under the agreement, the income of fiscally transparent entities will be treated as derived by each owner of the entity, to the extent of the share the owner has in the income.

Tax recovery agreements provide a mechanism by which participating countries can call on each other’s tax administrations to recover tax from absconding debtors.

The following rules relating to tax recovery agreements apply from 20 May 1999.

1. **Definitions**

A “tax recovery agreement” is:

(a) A convention or agreement negotiated to assist in the recovery of unpaid tax due to either or both of the Governments that are parties to the convention or the agreement; or

(b) A double tax agreement, to the extent that it provides for the recovery of unpaid tax.

“Competent authority” has the meaning provided in a double tax agreement or in a tax recovery agreement and includes the CIR.

“Contested act of assistance” means an act of or on behalf of a competent authority that a person affected by the act considers is inconsistent with a tax recovery agreement.

2. **Tax recovery agreements**

The Governor-General may, by Order in Council, declare that a tax recovery agreement has effect for unpaid tax. A tax recovery agreement has effect even if a provision in the agreement is inconsistent with a provision in the ITA or any other Act.

To the extent that the taxes are prescribed in a tax recovery agreement, the agreement may provide for assistance in the recovery of taxes imposed by the laws of New Zealand and the territory with which the agreement is negotiated.

Assistance in the recovery of taxes includes assistance in the recovery of charges associated with the taxes, including interest, administrative penalties, costs of collection or conservancy, or any other related amount.

3. **Requests for assistance**

A competent authority may make a request for assistance under a tax recovery agreement. A request for assistance must be accompanied by:

(a) Written particulars of the amount of unpaid tax to which the request relates and the extent, if any, to which the requesting party considers the unpaid tax is contested;

(b) A declaration made by the applicant’s competent authority that the unpaid tax is a tax prescribed in the agreement and that any other conditions in the tax recovery agreement concerning the making of a request have been complied with; and

(c) A certificate or notarised copy of the instrument that allows enforcement of the unpaid tax in the state of the applicant.

When assisting a competent authority in response to a request made under a tax recovery agreement, the CIR may apply any provision or exercise any authority, discretion, power, provision, or right that is available to the CIR under the laws of New Zealand with the exception of Parts 4A, 5, 5A, 6, 7, 8, 8A, 9 (except TAA, ss 143C to 143E) and 12 (except TAA, ss 203 to 205).

4. **Limitations on assistance**

The CIR may assist in recovering an uncontested amount of unpaid tax only if:

(a) Payment of the amount is enforceable under the laws of the state of the applicant requesting assistance under a tax recovery agreement; and

(b) The amount is owed by a person who cannot, under the laws of the state of the applicant, prevent collection of the amount.
The circumstances in which the CIR may provide assistance include the following, in relation to the amount of unpaid tax:

(a) The period within which the person may exercise a right to contest the assessment has expired;
(b) The person has withdrawn an objection in relation to the amount;
(c) The person has waived a right to contest the assessment;
(d) The person is required to pay some or all of the amount, regardless of any right to contest the assessment; or
(e) The person is otherwise unable, under the laws of the state of the applicant, to prevent collection of the amount.

Despite the above, the CIR may assist in recovering unpaid tax if, after consultation, the competent authorities determine that the taxpayer to whom the request for assistance relates:

(a) Acknowledges that the amount of unpaid tax will no longer be contested;
(b) May leave New Zealand in order to defeat recovery action;
(c) May take steps in relation to the existence or location of the taxpayer’s assets that make it more difficult for the CIR to recover the unpaid tax; or
(d) Is contesting the assessment solely to delay or frustrate recovery action.

Assistance must not be given:

(a) For an amount of unpaid tax that became uncontested more than 6 years before the tax recovery agreement entered into force in New Zealand; or
(b) If the request for assistance is first made more than 15 years after the date on which the unpaid tax became uncontested.

(5) Contested act of assistance
A person that claims to be affected by a contested act of assistance may advise the competent authority of the reasons why the person considers the act is a contested act of assistance. On receipt of such a request, the competent authority must, without undue delay:

(a) Endeavour to resolve with the person the dispute concerning the contested act of assistance; or
(b) Refer the request, together with reasons, to the competent authority of the other territory, and endeavour, by mutual agreement, to resolve the dispute.

This applies whether or not another remedy is available under the laws of New Zealand or the laws of the other party to a tax recovery agreement.

(6) Rights of appeal
A taxpayer may appeal to the District Court on a question of law or fact that arises from the exercise of any authority, discretion, power, provision, or right by the CIR or another competent authority in relation to tax recovery agreements. The District Court may reverse or modify the effect of the authority, discretion, power, provision, or right exercised, or refer the matter back to the CIR or the other competent authority for further consideration.

(7) Certificates by CIR
The CIR may sign a certificate on either of the following matters if the CIR first determines that assistance may be given:

(a) That the request is made under s 173E of the TAA (request for assistance); or
(b) That the request complies with the tax recovery agreement rules in Part 10A of the TAA.

A certificate purporting to be given under these provisions is, in the absence of proof to the contrary, sufficient evidence of the matters certified by the certificate.
(8) Inland Revenue commentary

The practical application of a recovery agreement will be a straightforward process of debt collection [see TIB vol 11/6 (July 1999) at 46-48]. A typical case where New Zealand is called upon to collect foreign tax will proceed as follows:

(a) New Zealand will receive a request for assistance in recovery, accompanied by relevant documentation, from a foreign state with which New Zealand has a relevant agreement.

(b) New Zealand will review the request to ensure that it complies with the provisions of the agreement and the empowering legislation.

(c) New Zealand will pursue recovery action in the same manner as it pursues a New Zealand tax debt.

(d) If the action is successful, New Zealand will pay the recovered amount over to the foreign state.

310.220 Tax information exchange agreements [s BH 1]

Tax information exchange agreements are bilateral treaties that provide for the exchange of information between the signatory states for the purpose of administering and enforcing domestic tax laws. They provide a mechanism whereby tax authorities can request tax records, business books and accounts, bank information, ownership information, and other tax-related information from each other for the purposes of preventing or investigating tax avoidance and evasion.

The tax information exchange agreements that New Zealand has signed, and their current status, is shown in the table below.

<table>
<thead>
<tr>
<th>Country</th>
<th>Date signed</th>
<th>Date in force</th>
<th>Effective in New Zealand from</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anguilla</td>
<td>11 December 2009</td>
<td>Not in force</td>
<td></td>
</tr>
<tr>
<td>Bahamas</td>
<td>18 November 2009</td>
<td>Not in force</td>
<td></td>
</tr>
<tr>
<td>Bermuda</td>
<td>16 April 2009</td>
<td>Not in force</td>
<td></td>
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<tr>
<td>British Virgin Islands</td>
<td>13 August 2009</td>
<td>Not in force</td>
<td></td>
</tr>
<tr>
<td>Cayman Islands</td>
<td>13 August 2009</td>
<td>30 September 2011</td>
<td>30 September 2011</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>9 July 2009</td>
<td>13 December 2011</td>
<td>1 January 2012</td>
</tr>
<tr>
<td>Curacao</td>
<td>1 March 2007</td>
<td>2 October 2008</td>
<td>1 January 2009</td>
</tr>
<tr>
<td>Dominica</td>
<td>16 March 2010</td>
<td>Not in force</td>
<td></td>
</tr>
<tr>
<td>Gibraltar</td>
<td>13 August 2009</td>
<td>13 May 2011</td>
<td>13 May 2011</td>
</tr>
<tr>
<td>Guernsey</td>
<td>21 July 2009</td>
<td>8 November 2010</td>
<td>1 April 2011</td>
</tr>
<tr>
<td>Isle of Man</td>
<td>27 July 2009</td>
<td>27 July 2010</td>
<td>27 July 2010</td>
</tr>
<tr>
<td>Jersey</td>
<td>27 July 2009</td>
<td>27 October 2010</td>
<td>27 October 2010</td>
</tr>
<tr>
<td>Marshall Islands</td>
<td>4 August 2010</td>
<td>Not in force</td>
<td></td>
</tr>
<tr>
<td>Netherlands Antilles</td>
<td>1 March 2007</td>
<td>2 October 2008</td>
<td>1 January 2009</td>
</tr>
<tr>
<td>Sint Maarten</td>
<td>1 March 2007</td>
<td>2 October 2008</td>
<td>1 January 2009</td>
</tr>
<tr>
<td>St Christopher and Nevis</td>
<td>24 November 2009</td>
<td>Not in force</td>
<td></td>
</tr>
<tr>
<td>St Vincent and the Grenadines</td>
<td>16 March 2010</td>
<td>Not in force</td>
<td></td>
</tr>
<tr>
<td>Samoa</td>
<td>24 August 2010</td>
<td>Not in force</td>
<td></td>
</tr>
<tr>
<td>Turks and Caicos Islands</td>
<td>11 December 2009</td>
<td>Not in force</td>
<td></td>
</tr>
<tr>
<td>Vanuatu</td>
<td>4 August 2010</td>
<td>Not in force</td>
<td></td>
</tr>
</tbody>
</table>
These agreements (which can be viewed on Inland Revenue’s Policy Advice Division website: www.taxpolicy.ird.govt.nz) are based on the model tax information exchange agreement, developed by the OECD, which grew out of the work undertaken to address harmful tax practices. The stated purpose of tax information exchange agreements is to promote international co-operation in tax matters through the exchange of information.

Agreements have also been entered into with the Marshall Islands and Samoa for the allocation of taxing rights with respect to certain income of individuals and to establish a mutual agreement procedure in respect of transfer pricing adjustments. The Orders giving effect to these agreements came into force on 13 January 2011. The agreements themselves will enter into force once domestic procedures for bringing them into effect have been completed.
Chapter 315
Duties and Levies

315.05 Duties and levies generally

In addition to income tax, fringe benefit tax, and GST, a number of miscellaneous forms of taxation are imposed in the way of duties and levies, including:

Duty/levy

Gift duty (repealed)
Cheque duty
Gaming duties
Problem gambling levy
ACC levies and premiums
Approved issuer levy

Relevant legislation
Estate and Gift Duties Act 1968
Stamp and Cheque Duties Act 1971
Gaming Duties Act 1971
Gambling Act 2003
[see 20 ACCIDENT COMPENSATION]
[see 1020.80]

Estate duty, originally imposed by the Estate and Gift Duties Act 1968, was abolished under the Estate Duty Abolition Act 1993 for estates of persons dying on or after 17 December 1992 [see 315.80].

Note: Gift duty has been repealed. It does not apply to any gifts made from 1 October 2011.

Stamp duty on the conveyance of land and the execution of leases, originally imposed under the Stamp and Cheque Duties Act 1971, was abolished with effect from 20 May 1999 under the Stamp Duty Abolition Act 1999.
Duties and taxes administered by the New Zealand Customs Service (GST on imports and excise duties) are not dealt with in *Staples Tax Guide*.

**315.10 Gift duty** [EGDA, ss 2(2), 61]

**Note:** Gift duty has been abolished in relation to all gifts made on or after 1 October 2011.

Gift duty on dutiable gifts is imposed by the Estate and Gift Duties Act 1968 (EGDA).

A gift is any disposition of property before 1 October 2011, other than by will, without fully adequate consideration in money or money’s worth passing to the person making the disposition. Partial or inadequate consideration given in exchange for property is treated as a gift to the extent of the inadequacy. Examples of inadequate consideration include:

(a) A transfer of a farm property to a farmer’s children in consideration of past services rendered by them. At law, past consideration is no consideration at all.

(b) A transfer of shares in a company at less than their market value.

(c) A transfer of property in discharge of a moral obligation on the part of the transferor.

The Taxation (GST and Miscellaneous Provisions) Act 2000 amended the EGDA by providing that when a financial arrangement is gifted it is treated as having been transferred at market value and so is exempt from gift duty. This amendment was repealed with effect from 10 October 2000 (the date of the original amendment) although financial arrangements transferred between 10 October 2000 and 2 April 2001 continue to be exempt from gift duty.

“Disposition of property” means any conveyance, transfer, assignment, settlement, delivery, payment, or other alienation of property (whether at law or in equity) includes:

(a) The issue of shares in a company;

(b) The creation of a trust;

(c) The grant or creation of a lease, mortgage, charge, servitude, licence, power, or other right, estate, or interest in or over property;

(d) The release, discharge, surrender, forfeiture or abandonment of a debt, contract, or a thing in action, or of any right, power, estate or interest in or over property;

(e) The exercise of a general power of appointment in favour of any person other than the holder of the power;

(f) A transaction or series of related transactions by which a person diminishes the value of their own estate and increases the value of another person’s estate.

The meaning of “disposition of property” was considered by the Court of Appeal in *Begg v Commissioner of Inland Revenue* (2009) 24 NZTC 23,473 (CA). This test case concerned gifting arrangements entered into by elderly clients of the Public Trust, by means of a “deed of gift and declaration of trust”. Under the deed, each donor made an immediate gift of an amount (typically $27,000) to each of their children, but payment of the gift was deferred until the donor died and their home was sold. The home remained in the name of the donor but was declared to be held in trust for the recipients (to the extent of their debt). The deed gave the recipients the right to secure the amount owing by requesting a mortgage over the title to the home, although this right was never exercised. The deed also provided for subsequent gifts to be made, on the same terms, by completing a gifting clause in a schedule attached to the deed. The main question for the Court was whether the arrangement was a disposition of property for gift duty purposes. The Court (Chambers J) held that:

(a) A trust had been created and therefore there was a disposition of property under paragraph (b) of the definition of “disposition of property”. An act can amount to a disposition of property without coming within the general part of the definition (ie the part of the definition before paragraphs (a) to (f)).

(b) The creation of the trust gave rise to an immediately dutiable gift. The donor’s home became “impressed with the terms of the trust” under the Public Trust template from the date of execution of the deed.
Duties and Levies

315.15

(c) Each separate transfer following the initial gift is the creation of a separate trust and is consequently a separate disposition of property.

(d) The decision reached by the Supreme Court in Perry v Commissioner of Stamps (1913) 32 NZLR 1194 (SC), on which the Public Trust relied in creating the gifting arrangement, was correct. A disclaimer of an interest under a disposition made inter vivos or by will, or of an interest under an intestacy, is not a disposition of property for gift duty purposes.

See also Inland Revenue Booklets Gift Duty (IR194) and Gift duty: A Guide for Practitioners (IR195).

315.15 Dutiable gift [EGDA ss 63, 64]

Gift duty is imposed only on dutiable gifts. A dutiable gift is:

(a) Any gift, wherever the property is situated, made by a donor to a donee where the donor is domiciled in New Zealand at the date of the gift, or is a body corporate incorporated in New Zealand; and

(b) Any gift of property situated in New Zealand, wherever the donor is domiciled or the body corporate is incorporated.

The rules for determining the situation of various classes of property are explained in 315.18.

A disposition of property made in performance or satisfaction of a voluntary contract is deemed to be a gift. A voluntary contract is defined as any contract entered into, whether written or unwritten, without fully adequate consideration in money or money’s worth. The contract is deemed to be voluntary only to the extent of the inadequacy.

Any gift that falls within the definition of a dutiable gift is subject to gift duty unless it is specifically exempted [see 315.20].

315.17 Domicile

A person’s domicile is where their permanent home is located. The Courts have interpreted the word “home” as having an everyday meaning and not just a person’s dwelling: Federal Commissioner of Taxation v Applegate (1979) 9 ATR 899, 79 ATC 4307 (FCA); Geothermal Energy New Zealand Ltd v Commissioner of Inland Revenue [1979] 2 NZLR 324, (1979) 4 NZTC 61,478 (SC); TRA Case H97 (1986) 10 TRNZ 189; TRA Case F138 (1984) 8 TRNZ 140; TRA Case U17 (1999) 19 NZTC 9,174.

In determining domicile, the Courts also appear to presume that a person’s domicile is in their country of origin unless the person can clearly demonstrate that they have chosen another country as their place of domicile: Bosworth v Commissioner of Inland Revenue (1973) 1 NZTC 60,996 (SC).

315.18 Situation of property [EGDA, s 63(2)]

Ordinarily, property is situated where it is physically located. Intangible forms of property are situated in the place they are most associated with. For example bank accounts are situated at the branch where the account is situated, contracts are situated where the contract is made, life insurance policies are situated where the policy is registered, and a business is situated where it is carried on.

Example:
A Fiji-domiciled person is a partner in a Fijian partnership carrying on business in that country. Although the partnership owns certain assets in New Zealand, the person’s interest in the partnership is property situated in Fiji.

The following rules apply for determining the situation of specific classes of property:

(a) A seagoing ship, or a share or interest in the ship, is situated in New Zealand if the ship is registered in New Zealand;

(b) Property at sea, other than a seagoing ship, is situated in New Zealand if in the course of transit directly or indirectly to New Zealand;

(c) The situation of debt payable under a bond or other deed is not determined by where the bond or deed is situated;

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Duties and Levies

(d) Debt owing by a corporation, wherever incorporated, is situated in New Zealand if the debt was incurred or payable in New Zealand and the corporation has an office or place of business in New Zealand;

(e) A debt owing by a person or persons other than a corporation is situated in New Zealand if any of the debtors are resident in New Zealand;

(f) A debt owing by the Crown is situated in New Zealand if it was incurred or is payable in New Zealand;

(g) Despite the above, a debt represented by an instrument that is negotiable in New Zealand is situated in the country in which the instrument is situated;

(h) Despite the above, a debt secured by mortgage, charge or otherwise on any property situated in New Zealand is itself situated in New Zealand. However, if the value of the security is less than the value of the debt, the debt is situated in New Zealand only to the extent of the value of the security;

(i) Shares in a company incorporated in New Zealand are situated in New Zealand; and

(j) Shares in a company incorporated outside New Zealand are situated outside New Zealand, except shares registered in a branch register in New Zealand under any law in force in another part of the Commonwealth.

315.20 Exempt gifts [EGDA, ss 71, 72, 73, 74, 74A, 74B, 74C, 75, 75A, 75B, 75C, 75D]

The following types of gifts are exempt from gift duty:

(a) Gifts totalling no more than $2,000 in any one calendar year made by the same donor to the same donee, in good faith as part of the normal expenditure of the donor — for example, cash gifts to members of a donor’s family [EGDA, s 71].

(b) Gifts for the maintenance or education of the spouse [see 960.10] or any relative of the donor, provided the gifts are not excessive in amount having regard to the legal or moral obligation of the donor [EGDA, s 72].

(c) Any gift creating a charitable trust or establishing a society or institution exclusively for charitable purposes, or any gift in aid of any such trust, society or institution. From 1 July 2008, the trust, society or institution must be registered as a charitable entity under the Charities Act 2005 in order to be exempt from gift duty [see 150.50]. Gifts to the following organisations are specifically exempted:

Gifts required by an order of a court under the Law Reform (Testamentary Promises) Act 1949 or the Family Protection Act 1955 are exempt from gift duty from 24 May 1999.

Gifts to the following organisations are specifically exempted:

(i) New Zealand Historic Places Trust;

(ii) Gifts of protected New Zealand objects to the Crown, libraries, museums, or public institutions for the benefit of the public;

(iii) Museum of New Zealand Te Papa Tongarewa Board;

(iv) Arts Council;

(v) Health Research Council of New Zealand for health research;

(vi) Sport and Recreation New Zealand (formerly the Hillary Commission);

(vii) New Zealand Patriotic Fund Board, the Canteen Fund Board, or any Provincial Patriotic Council for any patriotic purpose;

(viii) Vocational Training Council;

(ix) New Zealand Council for Educational Research;

(x) Queen Elizabeth II National Trust;

(xi) A gift by a local authority to a community trust under specified circumstances [see s 73(2)(k), (ka) of the EGDA];
(xii) New Zealand Antarctic Institute:
(xiii) A Board of Trustees constituted under Part 9 of the Education Act 1989 and not carried on for the private pecuniary profit of any individual (from 1 July 2008);
(xiv) A tertiary education institution established under Part 14 of the Education Act 1989 and not carried on for the private pecuniary profit of any individual (from 1 July 2008) [EGDA, s 73].
(xv) An organisation (other than an educational institution) that is part of the State Services and is not carried on for the private pecuniary profit of any individual (from 7 September 2010);
(xvi) An organisation that is a local authority, a council-controlled organisation, or a subsidiary of a council-controlled organisation and is not carried on for the private pecuniary profit of any individual (from 1 July 2008);
(xvii) The trustee of the Tokelau International Trust Fund or the Niue International Trust Fund; and
(xviii) An organisation that is a donee organisation (as defined in s YA 1) (from 1 April 2008) [EGDA, s 73].

d) An election by a member to take a reduced retirement allowance or pension in a group superannuation scheme in return for the payment after death of a pension to a spouse, civil union partner, de facto partner or dependant, or for payment before a member’s death of a pension to the member’s spouse, civil union partner or de facto partner [EGDA, s 74].

e) A gift between members of the same consolidated group [EGDA, s 74A, see 190 COMPANIES - CONSOLIDATION].

f) A payment, distribution or transaction by a company, unit trust or group investment fund to another company, unit trust or group investment fund, where the payment, distribution or transaction constitutes a dividend for income tax purposes, or would constitute such a dividend if not for s CD 27 [EGDA, s 74B].

g) A gift from an amalgamating company (or from a shareholder in an amalgamating company) to an amalgamated company, where the gift occurs as part of the amalgamation [EGDA, s 74C].

h) A gift from a co-operative company (or a company owned by a co-operative company) to a member of the co-operative company, where the gift is excluded from being a dividend by s CD 34 [EGDA, s 74D].

i) The following payments or transfers, to the extent they are gifts:
   (i) Employer contributions to a group superannuation scheme for employees;
   (ii) Retirement payments, gratuities and bonuses (associated person restrictions apply);
   (iii) Payments made by an employer to the widow, widower, surviving civil union or de facto partner, or infant child of a deceased employee (associated person restrictions apply);
   (iv) Lump sum retirement payments that are deductible under s DC 1; or
   (v) Any issue or sale of shares under a share purchase scheme to an employee, to the extent that it is a gift [EGDA, s 75].

j) Up to 50 per cent of the total value of relationship property (as distinct from separate property) transferred under an agreement under the Property (Relationships) Act 1976, and any disposition of property by order of the Court under s 25 of the Property (Relationships) Act 1976, to the extent the disposition is to a current or former spouse, civil union partner or de facto partner for the benefit of minor or dependent children [EGDA, s 75A].

k) The forgiveness or remission of a liability under a financial arrangement, to the extent that, under the financial arrangements rules, it reduces a person’s deduction or increases their income. To the extent that a transaction is a dividend, it is not a gift for gift duty purposes [EGDA, s 75B].

l) Certain dispositions of property by the Waikato Electricity Authority [EGDA, s 75C].
(m) Certain dispositions of property upon the dissolution of the Raspberry Marketing Authorities [EGDA, s 75D].

### 315.25 Completion of a gift

A gift is not complete until the donor is unable to revoke it. It is important to know the date when a gift is completed as it is at that date that the gift is assessable. The date when a gift is made is also a factor in computing the duty imposed.

#### Examples of completed gifts

- **Cash**: On delivery.
- **Chattels**: On the actual handing over or delivery of the chattels or upon completion of a deed of assignment.
- **Cheque**: When presented by the donee and honoured at the bank.
- **Company shares**: At the earlier of when a registrable transfer duly executed by the donor is handed to the donee and the date on which the company registers the instrument of transfer.
- **Land**: At the earlier of the date on which the instrument of transfer is registered and when the beneficiary is in possession of all documents necessary to effect the registration. However, where a valid trust is created, the trust’s creation date is used.
- **Mortgage release**: By an executed deed of release or forgiveness.

Dates of completion may differ for shares transferred under a system approved under s 7 of the Securities Transfer Act 1991.

#### Example:

A taxpayer gifts a section of land valued at $100,000 and shares valued at $1,500. The gift of land is completed at the date of registration with the Land Transfer Office, and the gift of shares is effective two weeks later when the company registered the transfer. Because gifts made within 12 months of each other must be aggregated, gift duty is calculated on the full $101,500.

### 315.30 Calculation of gift duty [EGDA, s 62, Schedule 3]

#### Note:
Gift duty is not payable on gifts made on or after 1 October 2011.

The gift duty rates (for dutiable gifts made between 1 April 1984 and 30 September 2011) are:

#### Value of gift

<table>
<thead>
<tr>
<th>Exceeding</th>
<th>Not exceeding</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>$27,000</td>
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<tr>
<td>$27,000</td>
<td>$36,000</td>
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<tr>
<td>$36,000</td>
<td>$54,000</td>
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<td>$54,000</td>
<td>$72,000</td>
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<td>$72,000</td>
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</tr>
</tbody>
</table>

Gift duty is charged and assessed on each separate dutiable gift according to the following formula:

\[
\frac{a}{b} \times c
\]

where

- \(a\) is the value of the dutiable gift;
- \(b\) is the value of the dutiable gift together with any dutiable gifts made at the same time or within 12 months subsequently or previously by the same donor to the same or any other donee; and
- \(c\) is the gift duty on item \(b\) according to the gift duty rates.
As each gift is made the gift duty is applied according to this formula. If one dutiable gift only is made within a 12-month period, then “a” and “b” are the same and the gift duty is the amount calculated under the schedule of gift duty rates. Where more than one gift is made within a 12-month period, the gifts are aggregated or totalled so as to calculate gift duty. The gifts must be made by the same donor but may be made to any number of donees.

Example:
Andy makes a dutiable gift of $30,000 on 1 January. Gift duty payable on this gift is $150 (five per cent of the excess over $27,000). This is due for payment when the gift is made (1 January). Andy then makes another dutiable gift of $10,000 on 31 August of the same year. Because gift duty must be calculated on all gifts made within a 12 month period, the two gifts must be aggregated. Gift duty on the total gifts ($40,000) is $850 ($450 plus 10 per cent of the excess over $36,000). Because gift duty of $150 has already been paid on the first gift, the amount due on 31 August is $700 ($850 - $150). The amount of gift duty payable on each gift is determined using the above formula. Gift duty on the first gift is:

\[(30,000 \div 40,000) \times 850 = 637.50\]

Gift duty on the second gift is:

\[(10,000 \div 40,000) \times 850 = 212.50\]

Andy then makes a third gift of $50,000 on 1 March of the following year. The first gift (made on 1 January of the previous year) was made more than 12 months ago and so is not aggregated with the third gift. However, the second gift was made less than 12 months ago and so must be aggregated with the third gift for calculating gift duty. Gift duty on the total ($60,000) is $3,450 ($2,250 plus 20 per cent of the excess over $54,000). Because gift duty of $212.50 has already been paid on the second gift, the amount due on 1 March is $3,237.50 ($3,450 - $212.50). The amount of gift duty payable on the second gift is:

\[(10,000 \div 60,000) \times 3,450 = 575.00\]

Gift duty on the third gift is:

\[(50,000 \div 60,000) \times 3,450 = 2,875\]

To summarise, the amount of gift duty payable on each gift is:

| First gift | $30,000 | $637.50 |
| Second gift | $10,000 | $575.00 |
| Third gift | $50,000 | $2,875.00 |

### 315.35 Valuation of dutiable gifts [EGDA, ss 66-69]

#### (1) General [EGDA, ss 66, 67]

For gift duty purposes, dutiable gifts are valued as at the date of making the gift. The valuations generally require expert opinion and must use methods approved by Inland Revenue. According to Inland Revenue (IR195, May 1999), the valuation of property generally calls for an enquiry as to the value at which a willing but not anxious vendor would sell and a willing but not anxious purchaser would buy.

#### (2) Land [EGDA, ss 68A, 68B]

The valuation of land is determined by agreement with Inland Revenue. In the absence of agreement, the value is determined by Inland Revenue. If the value of the land is determined by Inland Revenue, one of the following two methods must be used:

(a) The capital value of the land in the district valuation roll plus the cost of any improvements not included in that valuation; or

(b) A special valuation of the capital value of the land made by a registered valuer.

If Inland Revenue determines the value of land using capital value, the donor may, within one month of the date of the original valuation, require Inland Revenue to revalue the land by a special valuation. The fee for the special valuation may be recovered by Inland Revenue from the donor. The donor may also object to a special valuation provided this is done within one month.

Inland Revenue will accept valuations from a registered valuer, Quotable Value New Zealand or an associate member of the Real Estate Institute of New Zealand. Rating valuations are generally not accepted if more than six months old. The value of land includes any growing or standing timber on the land.
(3) **Shares [EGDA, s 68C]**

The valuation of shares does not take into account any restrictive provisions on share transfers or alienation, except to the extent that the restrictions are (in Inland Revenue’s opinion) reasonable. In determining what is reasonable, contributions by a shareholder to the company by way of services, management, capital or otherwise, and benefits received from the company by that shareholder must be considered.

(4) **Controlled companies [EGDA, s 68D]**

The value of a debt must be determined disregarding the fact that the debt, or any part of it, is not payable before the date of valuation if the debt is owed to a donor or a controlled company by:

(a) A person connected with the donor by blood relationship, marriage, civil union or de facto relationship, or adoption;
(b) A controlled company; or
(c) A trustee for either of the above.

This does not apply if Inland Revenue is satisfied that the donor or the controlled company and the debtor dealt with each other in an arm’s-length manner.

A controlled company is a company controlled by or on behalf of:

(a) The donor;
(b) Any person connected with the donor by blood relationship, marriage, civil union or de facto relationship, or adoption; or
(c) The donor and any connected person.

Control may be direct or indirect or through the holding of a majority of shares in the company or any other company, or in any other manner whatsoever.

(5) **Share or interest in partnership [EGDA, s 68E]**

The valuation of a share or interest in a partnership does not take into account any provision in an agreement or arrangement by the partners that restricts the value of that share or interest, except to the extent that the restrictions are (in Inland Revenue’s opinion) reasonable. In determining what is reasonable, Inland Revenue must consider contributions by the partners to the partnership by way of services, management, capital, or otherwise, and benefits received from the partnership by the partners.

(6) **Annuities and life interests [EGDA, s 68F]**

The value of an annuity or other interest for the life of a person or for any other period, or the value of an interest expectant on the death of any person or on any other event, is calculated using Tables A to D of the Second Schedule to the EGDA.

(7) **Contingent interests [EGDA, s 68G]**

The valuation of contingent interests is determined in a manner that considers how the contingency is expected by Inland Revenue to arise. If the contingency arises in a manner different from expected, the interest must be revalued on the basis of the actual event. The possibility that a widow may remarry is not a contingency.

(8) **Property subject to encumbrances [EGDA, s 69]**

If property is gifted that is subject to any encumbrance, such as a mortgage, charge, or liability, no deduction is allowed from the total value of that property if and to the extent that the donee has a right of contribution or indemnity against any other person in respect of that encumbrance.

**315.40 Valuation when benefit reserved to donor [EGDA, s 70]**

When a dutiable gift is made in consideration of, or with the reservation of, any benefit or advantage to or in favour of the donor, no deduction can be made in respect of that benefit or advantage in calculating the value of that gift.

“Benefit or advantage” means any benefit or advantage whether by way of:
(a) Any interest or estate in the property;
(b) Mortgage or charge;
(c) Any annuity or other payment;
(d) Any contract for the benefit of the donor; or
(e) Any condition or power of revocation or other disposition.

It also includes any benefit or advantage provided in any other manner whatever. It does not include any annuity or payment to the extent that the annuity or payment is:

(a) Of a fixed or ascertainable amount in money payable over a fixed or ascertainable period, or for life, or at a fixed or ascertainable date or dates, or on demand; and
(b) Secured to the donor by way of a mortgage or charge over the property, by an agreement for the sale and purchase of land, by a written agreement to lease land, or by deed, in each case executed by the donee.

A common tax-planning arrangement involves a person granting a “lease for life” to themselves and then transferring the balance of the property to another person or to a trust. Whether or not an income tax liability arises depends on how the arrangement is structured. The CIR had issued nine Public Binding Rulings (BR Pub 02/02 to BR Pub 02/10, all of which expired on 31 April 2005), setting out the income tax and gift duty implications of various permutations of these arrangements [see 3000.10 and TIB vol 14:12 (December 2002) at 15-23].

The purpose of s 70 of the EGDA is to prevent the value of any benefit reserved from a gift by the donor from being deducted from the value of the dutiable gift. In determining whether s 70 applies, it is important to distinguish between a reservation and a retention. Property is reserved if, under the arrangement, some of the property gifted is to be given back to the donor. If the transferor reserves part of the property transferred, that part of the property is included in the value of the dutiable gift. If the transferor retains part of some property and then transfers the balance, the part of the property retained is not included in the value of the dutiable gift.

Public rulings BR Pub 02/02 to BR Pub 02/10 in TIB vol 14:12 (December 2002) at 15-23, explain how the CIR would treat a variety of arrangements for the purposes of s 70 of the EGDA. In general, the effect of the rulings can be summarised as following:

(a) Where the transferor grants an interest in property to themselves, and later transfers the balance or reversionary interest in the property to another person, there is no reservation and s 70 does not apply.
(b) Where a transferor transfers property to another person, and the parties intend that all the property rights in the property be transferred and than later an interest be granted back, there is a reservation and s 70 applies.
(c) Where a transferor grants a property right to themselves, and simultaneously transfers the balance or reversionary interest to a transferee, there is no reservation and s 70 does not apply.

The rulings all expired on 31 April 2005.

315.45 Gift statement [EGDA, ss 79, 80]

When the value of a gift exceeds $12,000, or when the value of a gift when aggregated with the value of all other gifts made within 12 months prior to the gift in question exceeds that amount, a gift statement (form IR635) must be completed and filed with Inland Revenue by the donor within three months of a gift being made. If the gift was created or evidenced by a written instrument, the instrument or a copy of it must accompany the gift statement.

If the donor fails to file the gift statement within three months, the donee (or the donee’s trustees, if any) is required within a further period of one month to file the gift statement.
315.50  **Payment, interest and penalty** [EGDA, ss 83-87]
Gift duty is a debt payable to the Crown by the donor, but may also be recovered from the donee. Unless otherwise provided under the terms of the gift, the donee is entitled to be indemnified by the donor against liability for the gift duty.
Gift duty is a charge on the property that comprises the gift.
Payment of gift duty becomes due upon the making of the gift. However, no liability for interest or penalties arises provided the duty is paid within six months of the date the gift was made.
Where gift duty (or additional gift duty) becomes payable because of the aggregation of a gift with a subsequent gift, the duty (or additional duty) on the first gift is payable on the making of the subsequent gift.
If the gift duty is not paid within six months of the making of the gift, a late payment penalty will be charged consisting of an initial penalty of five per cent and an additional one per cent for each month thereafter that the duty remains unpaid [see 1110.40]. Interest will also be charged on the overdue amount [see 1110.295].
Shortfall penalties may also apply if a donor fails to complete a gift statement, deliberately understates their liability for gift duty, or does not take adequate care in completing a gift statement [see 1110.85].

315.55  **Relief for gift duty paid overseas** [EGDA, s 77]
Where a dutiable gift is also subject to foreign gift duty, Inland Revenue will allow a rebate of 50 per cent of the lesser of the duty otherwise payable in New Zealand or the duty payable in the overseas country. The rebate only applies if the law of the other country allows a similar rebate.

315.60  **Cheque duty** [SCDA, ss 76-86]
Cheque duty is imposed under s 77 of the Stamp and Cheque Duties Act 1971, (SCDA). Cheque duty is payable on every bill of exchange (cheque) made or drawn, at the rate of 5 cents per bill of exchange.
“Bill of exchange” means an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer [Bills of Exchange Act 1908, s 3].
For cheque duty purposes, a bill of exchange includes a promissory note other than a bank note [SCDA, s 2]. “Promissory note” means an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person or to bearer (Bills of Exchange Act 1908, s 84).
Certain bills of exchange are exempted from cheque duty — for example, bills of exchange drawn by a person acting on behalf of the Crown and bills of exchange drawn under the National Provident Fund Act 1950. For a full list of exemptions see s 79 of the SCDA.
If a bill of exchange is drawn in a set and one of the set is stamped (for cheque duty), the other bill(s) in the set are not liable to cheque duty.
The CIR may exempt certain persons from cheque duty in consideration for the other party paying a sum equivalent to the cheque duty that would have been payable on bills of exchange drawn. This applies only to the Public Trust, Tower Corporation, State Insurance Limited, Housing New Zealand Corporation, and the Accident Compensation Corporation.
The CIR may licence a bank to supply its customers or to procure on its own behalf bill-of-exchange forms prepaid with cheque duty. A licensed bank must, within 21 days of the end of each quarter, provide to the CIR a statement of all bill-of-exchange forms prepaid with cheque duty supplied to its customers or procured on its own behalf during the quarter. The statement must be accompanied by the amount of duty payable for the quarter.
The CIR may also license a printer to print for the use of customers or on the printer’s own behalf bill-of-exchange forms prepaid with cheque duty. Quarterly statements and payments are required as for banks.
The drawer or maker of the bill must, before delivery, duly stamp any bill of exchange for which cheque duty is not prepaid. “Duly stamped” means affixing postage stamps or stamps on the face of the bill for the amount of cheque duty payable on the bill of exchange. Postage stamps must be cancelled so that they cannot be reused.

Late payment penalty and interest will apply to any duty not paid by the due date.

The CIR may, on application within eight years after the payment of the duty, refund the cheque duty on:

(a) Any prepaid bill-of-exchange forms that have not been used;
(b) Any bill-of-exchange forms for which cheque duty has been prepaid that have not been printed; and
(c) Any bills of exchange for which cheque duty has been paid that have been spoiled, defaced, lost, or destroyed before being acted on.

315.70 Gaming duties

Four types of gaming duties are imposed under the Gaming Duties Act 1971 (GDA):

(a) Totalisator duty;
(b) Lottery duty;
(c) Gaming machine duty;
(d) Casino duty.

The problem gambling levy [see 315.79] is collected along with gaming duties.

315.72 Totalisator duty [GDA, ss 4, 5]

Totalisator duty is payable at the rate of four per cent of betting profits. Betting profits are calculated using the following formula:

\[
\text{amounts} - \text{refunds} - \text{winning dividends}
\]

Where:

“amounts” is the total amount received by the Board or its agents (including the net returns from bets laid off) for totalisator racing betting, sports betting and fixed-odds racing betting.

“refunds” is the amount of refunds paid.

“winning dividends” is the amount of all winning dividends paid out in respect of amounts.

“Board” means the New Zealand Racing Board [Racing Act 2003, s 5(1)].

The Board is required to provide monthly returns to the CIR of totalisator duty payable, by the 20th of the following month. The amount of duty payable must be paid by the same date. The return should include the duty payable in respect of events for which the results have been declared during the month.

315.74 Lottery duty [GDA, ss 9-12A]

Lottery duty is payable at the rate of 5.5 per cent of the nominal value of all tickets represented in the drawing of a lottery, whether or not all those tickets are sold.

“Lottery” is defined in s 4 of the Gambling Act 2003 as a scheme or device in which multiple participants pay for the chance to go into a draw for prizes of money. It includes lotto, raffles and sweepstakes, and includes lotteries promoted by the Lotteries Commission.

The organiser of the lottery must furnish a return to the CIR within 14 days after the drawing of the lottery, setting out a statement of the lottery duty payable. The CIR may exempt an organiser from the need to file a return.

Lottery duty must be paid to the CIR within 14 days of the drawing of the lottery. Lottery duty is a debt due and payable to the Crown.

315.76 Gaming machine duty [GDA, ss 12B-12L]

Gaming machine duty is payable at the rate of 20 per cent of the gaming machine profits of dutiable games.
“Gaming machine profits” are the difference (which cannot be less than zero) between the total amount bet and the total amount of all prizes paid on all dutiable games during the return period. A return period is a calendar month.

“A dutiable game” means gambling by means of a gaming machine, but does not include casino gambling.

A gaming machine is a device, whether totally or partly mechanically or electronically operated, that is adapted or designed and constructed for use in gambling. Machines used to draw lotteries or dispense tickets, and random selection devices such as those used in housie, are not gaming machines.

Gaming machine operators must furnish monthly returns (on Inland Revenue Form IR680) to the CIR showing gaming machine profits and gaming machine duty payable for the month. The return is due by the 20th of the following month. The gaming machine duty showing as payable in the return must also be paid by the 20th of following month. If the amount of gaming duty payable on any due date is $5 or less, the CIR will take no action to collect that duty and no interest will be charged on it [GDA, ss 12D to 12FA].

The CIR may issue a default assessment if a person fails to file a return, if the CIR is not satisfied with a return filed, or if the CIR has reason to believe that a person is liable to pay gaming machine duty [GDA, s 12G(1)-(3)].

If a person has filed a return for any period and paid or been assessed for the gaming machine duty for that period, the CIR may not make an assessment or increase the amount of an assessment after four years from the end of the month in which the return was filed or the assessment was made. This time limit does not apply if the CIR believes that the person knowingly or fraudulently failed to disclose all material facts [GDA, s 12G(4)].

The disputes resolution procedures in Part 4A of the TAA and the challenges rules in Part 8A of the TAA apply to gaming machine duty assessments [GDA, s 12HA].

Gaming machine duty is recoverable as a debt due to the Crown. If the gaming machine operator does not pay any duty by the due date, liability for the debt is recoverable as follows:

(a) If the gaming machine operator is incorporated, the officers, trustees, and managers (including the secretary and treasurer) of the gaming machine operator are jointly and severally liable for the debt.

(b) If the gaming machine operator is not incorporated, the members, officers and trustees of the gaming machine operator are jointly and severally liable for the debt [GDA, s 12K].

For further information, refer to Inland Revenue Booklet Gaming Machine Duty (IR180).

315.78 Casino duty [GDA, ss 12M-12R]

Casino duty is payable at the rate of four per cent of the casino win. Casino duty applies only to casinos operated by persons licensed under the Gambling Act 2003 [GDA, s 12N].

“Casino win”, in relation to a return period, means the gaming income of the casino less the aggregate of:

(a) The gaming wins paid out by the casino; and

(b) The casino losses (if any) for the preceding return period.

A return period is a calendar month.

“Gaming income” is the total of money paid to purchase chips and money (other than chips) paid to play authorised games.

“Gaming wins” is the total of money paid to redeem chips and money (other than chips) paid as winnings on authorised games.

Casino operators must furnish monthly returns (on Inland Revenue Form IR199) to the CIR showing the casino win for the month and casino duty payable on that win. The return is due by the 20th of the following month [GDA, s 12O]. The casino duty showing as payable in the return must also be paid by the 20th of the following month [GDA, s 12P].

The assessment procedures for gaming machine duty [see 315.76] also apply for casino duty.
The disputes resolution procedures in Part 4A of the TAA and the challenges rules in Part 8A of the TAA apply to casino duty assessments.

Unpaid casino duty is recoverable from casino operators in the same way as for gaming machine duty [GDA, s 12R].

**315.79 Problem gambling levy** [Gambling Act 2003, ss 317-325]

Legislation providing for the introduction of a problem gambling levy was introduced by the Gambling Act 2003 [ss 317 to 325], and came into force on 19 September 2003. The levy was collected from 1 October 2004. The purpose of the levy is to fund the development, management and delivery of an integrated problem gambling strategy. The strategy will include:

(a) Measures to promote public health by preventing and minimising the harm from gambling;

(b) Services to treat and assist problem gamblers and their families and whānau; and

(c) Independent scientific research on the effects of gambling.

The levy is payable initially by the New Zealand Racing Board, gaming machine operators, casino operators and the Lotteries Commission. A formula for allocating the costs of the integrated problem gambling strategy among the various gaming sectors is provided in s 320 of the Gambling Act 2003.

The levy is charged at the rate of 1.11 per cent (plus GST) on gaming machine profits. The problem gambling levy is neither a tax nor a duty, but the powers of collection, recovery and enforcement in the Gaming Duties Act 1971 and the TAA apply as if the levy were a duty.

Inland Revenue collects the problem gambling levy along with gaming duty. There will be one combined gaming duty and problem gambling levy rate for each gaming sector [see TIB vol 15:11 (November 2003) at 25-26 for further details].

**315.80 Estate duty (abolished)**

Estate duty, originally imposed under the Estate and Gift Duties Act 1968, was abolished by s 3 of the Estate Duty Abolition Act 1993, for estates of persons dying on or after 17 December 1992. Immediately prior to its abolition, estate duty was charged on the final dutiable estate at the rate of 40 per cent of the value of estates having a dutiable value exceeding $450,000.
Chapter 320

Electronic Commerce

320.10 Terminology

Electronic commerce (or e-commerce) encompasses a range of activities based around the use of data transfer using digital technology, including EFT-POS, electronic banking, telecommunications and the internet. Vast improvements in telecommunications technology (particularly in speed and capacity) and a fall in the price of accessing the internet in recent years have led to a meteoric rise in the use of the internet as a means of conducting business. It is now possible to browse, order, purchase and pay for a wide range of goods and services over the internet, and an increasing range of services, such as information, software, music, graphics and video, can actually be delivered over the internet.

320.20 Taxation issues

There are currently no tax rules dealing specifically with e-commerce in New Zealand. From the taxation point of view, e-commerce is fundamentally no different from any other form of business and the same principles that relate, for example, to the determination of assessable income and deductions for businesses in general apply equally to e-commerce businesses. However, the unique nature of e-commerce can lead to difficulties in the interpretation of tax legislation written without modern technologies in mind. For example, when non-residents from countries with which New Zealand has entered into a double tax agreement derive business income from New Zealand, that income is not taxable in New Zealand unless the non-resident has a permanent establishment in New Zealand. A permanent establishment exists only if the non-resident has a physical place of business in New Zealand. Using a website (which does not need to be located in New Zealand), a non-resident can generate substantial business income from New Zealand without having a physical presence here. The question therefore arises as to whether a website is (or should be) a permanent establishment [see 320.37].

Other tax issues relating to e-commerce include the deductibility of website and related expenditure, the treatment of assets (including software), and the applicability of GST to e-commerce transactions. These issues are dealt with in subsequent paragraphs.

Widespread discussion at the governmental and international levels on the possible impact of e-commerce on tax revenue and tax administration has been generated in response to the growth in e-commerce [see 320.70].

320.30 Income from e-commerce [ss BD 1, CB 1]

For a resident conducting a business in New Zealand, income derived from e-commerce is determined in the same way as for any other type of business. Assessable income includes any amount derived from a business,
and residents are taxed on a worldwide basis. “Business” is defined as including any profession, trade, or undertaking carried on for profit [s YA 1, see 130 BUSINESS, 230 CORE PROVISIONS].

For non-residents, the liability of income from e-commerce to income tax in New Zealand depends on:

(a) Whether or not the income is derived from New Zealand [s YD 4, see 760.20];
(b) The existence or otherwise of a double tax agreement [see 310 DOUBLE TAX AGREEMENTS];
(c) If there is a double tax agreement, the type of income involved (different types of income are treated differently under double tax agreements, eg business income and royalties);
(d) If business income is involved and there is a double tax agreement, whether or not the non-resident has a permanent establishment in New Zealand [see 320.37].

320.35 Residence of e-commerce businesses [ss YD 1, YD 2]

The liability or otherwise of a business to income tax depends in part on whether the entity is resident in New Zealand. The rules for determining residence are set out in detail in 1250 RESIDENCE. Note that there are different rules for individuals and companies.

The residence rules may be summarised as follows:

(a) An individual is resident in New Zealand if the individual has a permanent place of abode in New Zealand or if the individual is personally present in New Zealand for a total of more than 183 days in any 12 month period.
(b) A company is resident in New Zealand if:
   (i) It is incorporated in New Zealand; or
   (ii) It has its head office in New Zealand; or
   (iii) It has its centre of management in New Zealand; or
   (iv) Control of the company by its directors is exercised in New Zealand.

320.37 Significance of permanent establishment

Income is deemed to be derived from New Zealand if it is derived from a business “wholly or partly carried on in New Zealand” [s YD 4(2)]. However, if the entity deriving business income from New Zealand is a resident of a country with which New Zealand has a double tax agreement, that income will be taxable in New Zealand only if the entity carries on the business through a permanent establishment in New Zealand.

The OECD Model Tax Convention (on which most double tax agreements are modelled) defines “permanent establishment” as “a fixed place of business through which the business of an enterprise is wholly or partly carried on”, including a place of management, branch, office, factory, workshop, mine, oil or gas well, or quarry. Under the Convention, “permanent establishment” does not include:

(a) Facilities used for the storage, display or delivery of goods belonging to the enterprise;
(b) Stocks of goods solely for the purpose of storage, display, delivery, or processing by another enterprise; or
(c) A fixed place of business used solely for purchasing goods, collecting information, or carrying on an activity of a preparatory or auxiliary character.

An enterprise will be deemed to have a permanent establishment in a state if an agent (other than an independent agent), who has the authority to conclude contracts on behalf of the enterprise, regularly acts on behalf of the enterprise in that state.

Difficulties may arise in attempting to apply the permanent establishment definition to certain e-commerce activities. For example, is a business website located in New Zealand a permanent establishment? This issue was considered by an OECD Technical Advisory Group, which stated (22 December 2000, at 5) [see 320.80]:

“… an internet web site, which is a combination of software and electronic data, does not in itself constitute tangible property. It therefore does not have a location that can constitute a ‘place
of business’ as there is no ‘facility such as premises or, in certain instances, machinery or equipment’ as far as the software and data constituting that web site is concerned. On the other hand, the server on which the web site is stored and through which it is accessible is a piece of equipment having a physical location and such location may thus constitute a ‘fixed place of business’ of the enterprise that operates that server.”

Inland Revenue’s Policy Advice Division has stated [see 320.80] that it supports the OECD view, in particular that:

(a) A website cannot, in itself, constitute a permanent establishment;
(b) A website hosting arrangement — where the website of a business is hosted by an internet service provider (ISP) — typically does not result in a permanent establishment;
(c) An ISP will not typically constitute a dependent agent of another enterprise so as to constitute a permanent establishment of that enterprise; and
(d) A business that owns or leases a server will not necessarily have a permanent establishment where the server is located.

However, as noted by Inland Revenue, the OECD has yet to address the issue of how to determine the profit that can be attributed to a permanent establishment, should one be considered to exist.

See 320.80 for other publications which discuss these issues in depth — in particular L Cox (March 2001) and A Ryan (November 1999).

**320.40 Deductibility of e-commerce expenditure** [s DA 1]

A taxpayer carrying on any business (including e-commerce) is allowed a deduction against assessable income for any expenditure or loss incurred by the taxpayer in deriving assessable income, or in the course of carrying on the business. In other words, to be deductible, the expenditure must either be related to producing assessable income or to the carrying on of a business whose purpose is producing assessable income [see 230 DEDUCTIONS].

According to Inland Revenue [see TIB vol 12:8 (August 2000) at 21-22], expenditure incurred in creating a website to be used in deriving assessable income is deductible in the following circumstances:

(a) Expenditure incurred in acquiring a website domain name is capital expenditure and therefore non-deductible under s DA 2(1). A domain name is not “depreciable intangible property” — see sch 14. As such, the expenditure incurred in acquiring the domain name is also not depreciable.

(b) The hypertext markup language (HTML) or other programming that makes up the website is an asset, being a computer program. The costs incurred in creating the website are appropriately categorised as capital expenditure.

(c) As a capital asset, the costs of creating the website must be capitalised and may be depreciated. To be depreciable, the software must be used in deriving assessable income. Computer software may be depreciated at a rate of 40 per cent diminishing value or 30 per cent straight-line [see 320.50].

(d) Ongoing costs of updating or adding to the information on a website are of a revenue nature, and are deductible when incurred if they satisfy the general permission in s DA 1. It is a matter of degree as to whether expenditure is updating and maintaining a website, and hence revenue, or a reconstruction or functional improvement to a website, which would be capital.

(e) Examples of deductible maintenance would include: updating the content of a web page, adding content to a web page, correcting minor errors or bugs in a website, and minor style or format changes relating to matters such as font types, font sizes and colours.

(f) Examples of non-deductible improvements would include: adding new features to a website (such as adding a sales capability with credit card processing features), adding extra pages to the website, upgrading the version of the software used in the website, and completely changing the layout and functions of the website sufficient to be a reconstruction.
The cost of renting space on a hypertext transfer protocol (HTTP) server is deductible, assuming the general permission [s DA 1] is satisfied. The annual renewal fee for registration of a domain name is also deductible.

The CIR’s policy on the income tax treatment of computer software generally is discussed in 250.410.

### 320.50 Depreciation of e-commerce assets

Assets that fall within the definition of depreciable property [ss EE 6, EE 7] and that are used to produce assessable income or to carry on a business may be depreciated for income tax purposes. Depreciation enables a percentage of the cost of an asset to be claimed as a deduction in each of a number of years. The rate at which the asset is depreciated depends on the estimated useful life of the asset. Depreciation rates are set by the CIR using statutory rules — a complete list of depreciation rates is provided at 5000 DEPRECIATION SCHEDULES. Generally, taxpayers can choose to depreciate an asset using either the straight line (SL) or the diminishing value (DV) method.

Some examples of depreciation rates for assets that might be used in an e-commerce business are as follows:

<table>
<thead>
<tr>
<th>Asset type</th>
<th>Straight-line rate</th>
<th>Diminishing value rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>EFTPOS terminals</td>
<td>40%</td>
<td>50%</td>
</tr>
<tr>
<td>Mainframe computers</td>
<td>21%</td>
<td>30%</td>
</tr>
<tr>
<td>Mini computers</td>
<td>40%</td>
<td>50%</td>
</tr>
<tr>
<td>Modems</td>
<td>40%</td>
<td>50%</td>
</tr>
<tr>
<td>Network servers</td>
<td>40%</td>
<td>50%</td>
</tr>
<tr>
<td>Personal computers</td>
<td>40%</td>
<td>50%</td>
</tr>
<tr>
<td>Printers</td>
<td>30%</td>
<td>40%</td>
</tr>
<tr>
<td>Software</td>
<td>40%</td>
<td>50%</td>
</tr>
<tr>
<td>Terminals (dumb)</td>
<td>21%</td>
<td>30%</td>
</tr>
<tr>
<td>Uninterruptible power supplies</td>
<td>21%</td>
<td>30%</td>
</tr>
</tbody>
</table>

The depreciation rules are explained fully in 250 DEPRECIATION.

### 320.60 GST and e-commerce

An overview of the GST regime is provided at 580.05.

Only businesses that are registered for GST are required to charge GST to their customers. Any business may register for GST if it is making taxable supplies [see 580.07 and 580.10]. However, a business whose taxable supplies exceed, or are likely to exceed, $60,000 in any 12-month period must register.

Most goods and services supplied in New Zealand are subject to GST at the rate of 15 per cent. Some goods and services, such as financial services, are exempt [see 580.20], while others are zero-rated [see 580.30].

A business that is resident in New Zealand and registered for GST will be required to charge GST on all goods and services it supplies in New Zealand. Exported goods are zero-rated [see 580.05]. Services physically performed outside New Zealand and services supplied to non-residents who are outside New Zealand at the time of supply are also normally zero-rated [see 580.05 to 580.43].

Businesses that are registered for GST may claim a credit for GST they pay on supplies they receive [see 580.120 to 580.124].

All goods imported into New Zealand are charged with GST by the Customs Department [see 580.100]. Imported services are subject to GST under a reverse charge mechanism (ie the recipient is liable to pay the GST on the supply), if the recipient of the services is registered for GST, less than 95 per cent of the supplies made by the recipient are taxable, and the supply would be taxable if made in New Zealand by a registered person [see 580.101].
A non-resident carrying on a taxable activity [see 580.95] and selling goods or services to customers in New Zealand is required to register for (and therefore charge) GST if the total value of the taxable supplies it makes has exceeded, or is likely to exceed, $60,000 in any 12-month period. Registration of non-residents is explained further at 580.83.

A supply is deemed to take place in New Zealand if the supplier is resident in New Zealand. For GST purposes, “resident” includes a person carrying on a taxable activity in New Zealand through a fixed or permanent place (eg a branch or office) in New Zealand. Supplies by non-residents are also deemed to take place in New Zealand if the goods are in New Zealand at the time of supply or the services are physically performed in New Zealand [see 580.50].

**320.70 International issues in e-commerce taxation**

Concern over the possible tax implications of growth in e-commerce is reflected in the widespread discussion of this issue at the international level. Much of this discussion is coordinated by the OECD. Five guiding principles have been formulated in OECD discussions [see 320.80, Ryan (October 1999)], on possible solutions to taxing e-commerce transactions:

(a) The tax treatment of e-commerce transactions should be neutral in comparison with conventional commerce. The tax treatment should not alter economic behaviour;

(b) The taxation of e-commerce transactions should be transparent and simple;

(c) Multiple international taxation should be avoided, to avoid economic distortions and to share tax revenue between countries according to economic activity;

(d) Compliance and administrative costs should be minimised so as not to inhibit trade;

(e) Tax rules should be flexible enough to cope with future developments in technology.

An OECD Ministerial conference in October 1998, *A Borderless World – Realising the Potential of Global Electronic Commerce*, endorsed the following key points from an OECD report [see 320.80]:

(a) Revenue administrators and business affirmed that widely accepted general tax principles should apply to the taxation of e-commerce;

(b) The taxation framework for e-commerce should be guided by the same taxation principles that guide governments in relation to conventional commerce;

(c) Countries should use e-commerce to develop taxation framework conditions for taxpayer service, tax administration, consumption taxes, and international tax norms;

(d) Member countries should work closely with all players including businesses, particularly small and medium enterprises, and non-member countries.

The above-mentioned OECD report confirmed that e-commerce raises tax policy and administration issues for revenue authorities. However, e-commerce is not new business but rather a new way of doing business, and many of the issues posed by e-commerce are simply extensions of existing problems created by international trade.

The ATO report *Tax and the Internet* [see 320.80], identified the following challenges posed by e-commerce for tax administrations:

(a) Difficulties in identifying the parties behind internet businesses;

(b) The ability of internet businesses to store tax records offshore or to encrypt them or alter them without trace;

(c) The possibility that some types of electronic money could exacerbate the problems of the physical cash economy;

(d) The removal of efficient tax collection points in the distribution chain from producer to consumer (“disintermediation”);

(e) The ability of the technologies to change the nature (and thus the tax treatment) of products through digitisation.
320.80 Further information

The following publications provide further information on tax issues relating to e-commerce.

Chapter 325

Emissions Trading

325.10 Introduction
An emissions trading scheme was introduced by the Climate Change Response Act 2002.

Under the scheme, certain participants are allocated units by Government either in recognition of their activities that remove greenhouse gases from the environment, or reduce the amount of gases entering the environment. Others are issued with units to assist them with the cost of the scheme.

Obligations are imposed on participants to surrender units based on the tonnage of greenhouse gases that are emitted by the activities that they undertake.

The following tax rules have been introduced to govern the tax treatment of emissions trading. The GST consequences of transactions involving units is covered in 580.48.

325.15 What is an emissions unit?
An “emissions unit” is a “unit” as defined in the Climate Change Response Act 2002. There are three types of unit included in the definition. These are:

(a) A Kyoto unit: These are specified in, or in accordance with, the Protocol. The Protocol is the Protocol to the United Nations Framework Convention on Climate Change (“the Kyoto Protocol”). These include assigned amount units, certified emission reduction units, emission reduction units, long-term certified emission reduction units, removal units, and temporary certified emission reduction units.

(b) A New Zealand emissions unit: This is a unit issued by the Registrar and designated as a New Zealand unit.

(c) An approved overseas unit: This is a unit, other than a Kyoto unit, which has been issued by an overseas registry and prescribed as being a unit that may be transferred to accounts in the registry.

There is also a fourth type of unit known as a “non-Kyoto greenhouse gas unit” This is a unit that is issued by reference to the sequestration, reduction or avoidance of emission of human induced greenhouse gases, has been verified to an internationally recognised standard and is not an “emissions unit”. These are often referred to as “grey units”.

For tax purposes:

(a) Neither an emissions unit nor a non-Kyoto greenhouse unit is “trading stock”;

(b) An “emissions unit” is revenue account property, as is a non-kyoto greenhouse gas unit;

(c) Both emissions units and non-Kyoto greenhouse units are excepted financial arrangements;
Emissions Trading

A project agreement entered into between the Crown and a participant under the Crown’s Projects to Reduce Emissions programme is a financial arrangement.

325.20 Acquisition, sale, surrender or conversion of an emissions unit

[ss CB 36, CX 51B, CX 51C, DB 60, ED 1B]

(1) Acquisition of a free unit

Where a unit is transferred to a person for a price of zero, under s 64 or Part 4, subpart 2 of the Climate Change Response Act 2002, or in relation to a forest sink covenant entered into by the person, no deduction is allowed for expenditure or loss incurred as consideration for the unit [s DB 60].

(2) Disposal of a unit

The amount derived on the disposal of an “emissions unit” is income. However, the income is excluded income (not taxable) where:

(a) The unit is a pre-1990 forest land emissions unit and the person would not derive income other than exempt or excluded income from a disposal (without timber) of the land to which the emissions unit relates [s CX 51B]; or

(b) The unit is a fishing quota emissions unit and the person would not derive income other than exempt or excluded income from a disposal of the quota to which the emissions unit relates [s CX 51C].

(3) Surrender of a unit

If the disposal was by way of surrender under the Climate Change Response Act 2002:

(a) The unit is deemed to have been sold to an unrelated person;

(b) The disposal is deemed to occur at the time of surrender.

(4) Disposal value

The deemed disposal value is zero if:

(a) The person surrenders the emissions unit for emissions in relation to post-1989 forest land;

(b) The person surrenders the emissions unit in relation to the deforestation of pre-1990 forest land if a disposal of that land (without timber) at the time of the surrender would result in the person deriving assessable income; or

(c) The person transfers the emissions unit to the Crown under a forest sink covenant.

The deemed disposal value is the unit’s market value if:

(a) The person surrenders a post-1989 forest land emissions unit or a forest sink emissions unit other than:

(i) For emissions in relation to post-1989 forest land; or

(ii) By a transfer to the Crown under a forest sink covenant.

(b) The person surrenders the emissions unit before the period of the emissions to which the unit relates; and:

(i) The unit was transferred to the person at a price of zero as part of an allocation of free units to industry, fishing vessel operators and agriculture a price of zero under Part 4, subpart 2 of the Climate Change Response Act 2002; and

(ii) The unit is not a “forest land unit”.

If neither zero nor market value applies (see above), and provided that s ED 1(7B) applies to the unit, the deemed disposal value is its value under s ED 1(7B).

Section ED 1(7B) applies to a unit where any one or more of the following applies:

(a) The unit was a free unit which was transferred under s 64 of the Climate Change Response Act 2002 (entitlement to receive units for the person’s removal activities) or under Part 4, subpart 2 of the
Climate Change Response Act 2002. These units have a value of zero during the period from the date of transfer to a date that is before the end of the income year of transfer;

(b) The unit is a forest land emissions unit or a replacement forest land emissions unit. These units have a zero value at the end of each income year.

(c) The unit is an emissions unit to which s ED 1B applies. These are free units which have been transferred to the person under s 64 or Part 4, subpart 2 of the Climate Change Response Act 2002 and are held continuously to the end of the income year. They relate to a quantity of emissions or emissions-related costs in a period that ends during or after the income year. They are neither forest land emissions units replacement forest land emissions units nor fishing quota emissions units. The units must not have been assigned a cost under s ED 1B(3)(a) for an earlier income year (see item (ii) below). The value at the end of the income year of units to which s ED 1B apply is as follows:

(i) If the emissions unit period begins after the end of the income year, the value is zero.

(ii) If item (i) above does not apply and the emissions unit period ends after the end of the income year, the value is market value for the number of units calculated under the formula contained in s ED 1B(4) and zero for the balance of the units;

(iii) If the emissions unit period ends during or at the end of the income year, the value of the units is their market value.

If none of the above items apply, the unit’s deemed disposal value is its cost.

(5) Conversion of a unit
Where a person converts a New Zealand emissions unit (other than a forest land unit) into a Kyoto emissions unit, a deemed disposal occurs. The unit is treated as having been sold for an amount equal to the value of the unit under s ED 1(7B) (see above) if that section applies to the unit. Otherwise, the unit is deemed to have been sold at cost.

325.25 Emissions units derived under projects to reduce emissions programme  [ss CB 1, CB 36]

Where a project agreement has been entered into between the Crown and a participant under the Crown’s Projects to Reduce Emissions programme, the project agreement is a financial arrangement. Emissions units derived by the participant under the agreement are income under s CB 1 with the amount of the income being equal to the value of the units transferred to the participant. If units (or their cash equivalent) are required to be refunded to the Crown, the refunded amount is deductible. Any amount received from the sale of units is also income [see Public ruling BR Pub 08/03, TIB vol 20:10 (December 2008) at 4-20].

325.27 Permanent forest sink initiative  [ss CB 36 DB 60B, ED 1, GC 3B]

A permanent forest sink initiative is an agreement entered into between the Government and a forester whereby the forester covenants to limit their rights to fell their trees. In return for entering into the covenant, the forester receives emissions units from the Government. For tax purposes the receipt and surrender of units is treated in the same way as the receipt and surrender of units under the post-1989 forest scheme [see 325.35]. Thus the receipt of units can give rise to taxable income and the surrender of units can give rise to a tax deduction. Both the receipt of units and the surrender of units is dealt with on a cash basis.

325.30 Pre-1990 Forest land units  [ss CB 36, CX 51B, DB 60B]

(1) Definitions

A “pre-1990 forest land emissions unit” is an emissions unit that was transferred to the person under Part 4, subpart 2 of the Climate Change Response Act 2002 in relation to pre-1990 forest land and that has been held by that person since its issue. It includes units that have been transferred to the person under a provision of a forestry rights agreement relating to the allocation of income or emissions units between the recipient and the person. It also includes units that have been received by the taxpayer from the person appointed by the Minister to receive units under Treaty of Waitangi settlements.
“Pre-1990 forest land” is defined in the Climate Change Response Act 2002 as being land that was forest land on 31 December 1989, remained as forest land on 31 December 2007 and still is a forest. It must consist predominantly of exotic forest species. It does not include land that has been deforested where any liability to surrender units has been satisfied and that liability arose from deforesting an area of more than two hectares in the five-year period commencing on 1 January 2008 or in any subsequent five-year period. This exclusion applies even where the deforested land has been declared exempt land.

(2) **Sale or surrender [s CX 51B]**
Where a pre-1990 forest land unit is sold or surrendered, the value of that disposal is determined under s CB 36 [see 325.20].

The sale to another person of a pre-1990 forest land emissions unit is excluded income if, at the time of disposal a sale or disposal (without timber) of the forest land to which the unit relates would not result in the person deriving assessable income [s CX 51B].

(3) **Surrender of pre-1990 unit for post-1989 emissions**
Where a person surrenders a pre-1990 forest land unit to meet a liability to surrender units in relation to post-1989 forest land, the person is deemed to have disposed of the pre-1990 forest land unit to an unrelated person and as having then reacquired it. Both the deemed disposal and the deemed reacquisition occur at the market value of the unit at that time. The result is that any gain on deemed disposal of the pre-1990 unit is realised for tax purposes at that time.

(4) **Emissions liabilities in relation to pre-1990 forest land [s DB 60B]**
No deduction is available for any liability incurred for emissions relating to pre-1990 forest land.

(5) **Value of units at year end s ED 1(5B)**
Section ED 1(5B) applies to the valuation of units on hand at year end with the effect that these units are not able to be pooled with other units [see 325.40].

### 325.35 Post-1989 forest land units [ss CB 36, CX 48, DB 60B]

(1) **Definitions**
A “post-1989 forest land emissions unit” is an emissions unit that was transferred to a person under s 64 Climate Change Response Act 2002 for growing trees on post-1989 forest land and that has been held continuously by that person since its issue. It includes units that have been transferred to the person under a provision of a forestry rights agreement relating to the allocation of income or emissions units between the recipient and the person.

“Post-1989 forest land” is:
(a) Land that was not forest land on 31 December 1989, or was forest land on that date but was deforested between 1 January 1990 and 31 December 2007;
(b) Land that was non-exempt pre-1990 forest land that was deforested on or after 1 January 2008 where any liability to surrender units has been satisfied and that liability arose from deforesting an area of more than two hectares in the five-year period commencing on 1 January 2008 or in any subsequent five-year period; or
(c) Exempt land that has been deforested where the number of units that would have been required to be surrendered had it been non-exempt pre-1990 forest land (see item (b) above) have been surrendered.

(2) **Sale or surrender**
Where a post-1989 forest land unit is sold or surrendered, the value of that disposal is determined under s CB 36 [see 325.20].
325.37 Fishing quota emissions units [ss CB 36, CX 51C, DB 61, ED 1]

(1) Definitions
A “fishing quota emissions unit” is an emissions unit that was transferred to a person under s 74 of the Climate Change Response Act 2002 to a person who is the owner of individual transferable quota and that unit has been held continuously by that person since its issue.

(2) Sale or surrender
Where a fishing quota emissions unit is sold to another person, the sale proceeds are excluded income unless the unit is held on revenue account. Where the unit is surrendered, rather than sold, the treatment set out in s CB 36 (10) applies [see 325.20]. Section DB 61 treats the person as having disposed of the unit to an unrelated person and then to have reacquired it, in both cases at market value. The result is that any gain on deemed disposal of the unit is realised for tax purposes at that time.

(3) Value of units at year end [s ED 1(5B)]
Section ED 1(5B) applies to the valuation of units on hand at year end with the effect that these units are not able to be pooled with other units [see 325.40].

325.40 Value of emissions units at year end [ss ED 1 ED 1B]
As emissions units are excepted financial arrangements, they are required to be valued at cost at the end of each income year. Costs are required to be allocated on either the first-in-first-out (FIFO) or the weighted average cost method.

Restrictions apply to which emissions units can be aggregated together when applying the chosen cost method. None of the following types of emissions unit can be aggregated or pooled together with units of another type:

(a) Pre-1990 forest land emissions units relating to pre-1990 forest land, if the holder of the units would derive assessable income from a disposal of the land without timber;
(b) Post-1989 forest land emissions units;
(c) Forest sink emissions units;
(d) Replacement forest land emissions units;
(e) Fishing quota emissions units, if the holder of the units would derive assessable income from a disposal of an individual transferable quota to which the units relate;
(f) Pre-1990 forest land emissions units relating to pre-1990 forest land, if the holder of the units would derive no assessable income from a disposal of the land without timber;
(g) Fishing quota emissions units, if the holder of the units would derive only exempt or excluded income from a disposal of an individual transferable quota to which the units relate;
(h) Emissions units issued for no consideration to which s ED 1B applies [see below]; and that have not been assigned a cost under s ED 1B(3)(a) [see below].

Notwithstanding the above restriction, emissions units described in items (a) to (e) above, can be pooled together, but not with any other types of emissions unit.

(1) Exceptions to the requirement to value at cost
Some units are valued at zero value at year end. Those that qualify for this treatment are set out in s ED 1(7B) and s ED 1B.

Those that qualify under s ED 1(7B) are:

(a) Forest land emissions units. These are valued at zero at the end of each income year.
(b) Replacement forest land emissions units. These are valued at zero at the end of each income year.
(c) An emissions unit transferred under s 64, or Part 4, subpart 2, of the Climate Change Response Act 2002 for zero consideration. These are, in the case of s 64, units allocated in consideration of a person’s
emissions removal activities and, in the case of Part 4, subpart 2, the free units issued to industry groups that have high emissions liabilities and compete on the international markets. We refer to these units as “industry units”. Industry units have a zero value at all times from the date on which they are transferred up to, but not including, the end of the income year in which the transfer occurred. Their value at the end of the income year is determined by s ED 1B.

Section ED 1B applies where the emissions units:

(a) Were held at the end of the income year and meet all of the following criteria:
   (i) Were industry units transferred to the person for a price of zero or were transferred to the person by a public authority under a supplementary agreement to a negotiated greenhouse agreement;
   (ii) Are held continuously by the person to the end of the income year;
   (iii) Have not been valued as a unit shortfall in a previous income year; and
   (iv) Are not forest land emissions units, replacement forest land emissions units, or fishing quota emissions units.

Their year-end value depends on whether or not there was an emissions shortfall in previous income years. An emissions shortfall occurs where there were insufficient free units transferred to the person in the previous income year. As units are allocated on the basis of the prior year’s production, an insufficient allocation will occur where the production level is increasing.

Where there was no unit shortfall in the previous year, it is necessary only to look at the current income year. To the extent to which the correct number of units have been transferred in the current income year, they are valued at market value. If too many have been transferred, the excess is valued at zero. Excess units will either be transferred back to government or offset against a future allocation.

If there is a unit shortfall (too few units have been transferred) the number actually transferred are valued at market value. The shortfall is also valued at market value and, when the shortfall is made up in the following year, an adjustment will occur to ensure that they are not counted twice.

The formula is under which this calculation is undertaken is:

\[
\text{unit entitlement} - \text{disposals at zero value}
\]

“Unit entitlement” is the total for the income year of amounts, each of which the person would have for a period of overlap between the calendar year ending 31 December and the income year if the period of overlap were treated as a year, of (any one or more of):

(i) Final allocation entitlement under s 83 of the Climate Change Response Act 2002;
(ii) Allocation entitlement under s 85 of that Act;
(iii) Emissions units corresponding to the actual emissions amount under a supplementary agreement to a negotiated greenhouse agreement.

“Disposals at zero” value is the number of emissions units disposed of by the person in the income year that had a value of zero at the disposal.

325.45 Anti-avoidance [ss GC 1, GC 3B]

Section GC 3B provides that emissions units are included in the definition of "trading stock" for the purposes of the anti-avoidance rules in s GC 1. However, there are some exceptions. The rule does not apply to:

- The surrender of a unit under the Climate Change Response Act 2002;
- The transfer of a unit to the Crown under a forest sink covenant under s 67Y of the Forests Act 1949; or
- The transfer of a forest land emissions unit by the person who receives it from the Crown to a person as a party to a forestry rights agreement as required by that agreement relating to the allocation of income or emissions units between the two parties.
The effect of the application of s GC 1 is that, where a person disposes of a unit for less than market value, the person is treated as having derived market value from the sale and the person to whom the unit was sold is treated as having paid market value for it.
## Chapter 330

### Employee Allowances

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<th>Description</th>
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<tbody>
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<tr>
<td>330.90</td>
<td>Deduction for retiring allowance paid to employee</td>
</tr>
</tbody>
</table>

### 330.10 Amounts derived in connection with employment [s CE 1]

Allowances derived in connection with employment are specifically included as income under s CE 1(a). Benefits of a non-cash nature are not assessable income with the exception of accommodation provided in connection with employment [330.45]. Non-cash benefits are covered by fringe benefit tax rules, and are regarded as excluded income [s CX 3]. By definition in s BD 1(5), assessable income does not include excluded income.

Taxable allowances should be added to salary and wages, and have PAYE deducted. Non-taxable (reimbursing) allowances should be recorded in the employer’s wagebook, but do not need to be shown on the employer monthly schedule (IR348).

### 330.15 Deductibility of employee allowance expenditure [s EA 3]

Expenditure incurred by an employer in providing allowances to employees is deductible if it satisfies the general permission [s DA 1], and none of the general limitations [s DA 2] apply.

If an allowance is based on an estimate of the amount of expenditure that an employee will incur, and some or all of that allowance is paid in advance, an adjustment may have to be made if part of the allowance relates to a subsequent income year. For the purposes of the prepayments rules, an allowance that is exempt under ss CW 17 or CW 18 is treated as a payment for services and the services are treated as being performed in the income year that the employee’s expenditure is expected to occur [s EA 3(7)].

**Example:**
The marketing manager of a company is paid a monthly allowance of $500 to cover his miscellaneous travel and entertainment costs. The allowance is based on an estimate of the expenditure he normally incurs. The allowance is paid in advance, so that the allowance for April expenses is paid at the end of March. Because the expenditure was incurred in March, it is deductible in the year ended 31 March. However, assuming the company has a standard balance date, the $500 payment is unexpired expenditure as at 31 March and must therefore be added back to income for the year ended 31 March and claimed as a deduction in the following income year.
However, an adjustment for unexpired expenditure is not required if any of the exemptions in Determination E12 apply [see 1140.70]. Thus, to continue the previous example, provided the total amounts of prepaid reimbursing allowances (ie that relate to a subsequent income year) paid to all employees do not exceed $14,000 and do not relate to a period of more than six months after balance date, no adjustment under s EA 3 will be required [Determination E12, paragraph (i) of the Schedule].

330.20 Reimbursing expenditure and expenditure on account of an employee [s CW 17]

An amount paid by an employer in respect of an employee’s employment or service is exempt from tax to the extent that it meets either of these conditions:

(a) It reimburses the employee for expenditure for which the employee would be allowed a deduction, if the employment limitation did not exist; or

(b) It is expenditure on account of an employee for which the employee would be allowed a deduction if they incurred the expenditure, and if the employment limitation did not exist.

The key requirement for the exemption is that it must reimburse employees for expenditure that would be deductible to the employee if the employee limitation [s DA 2(4)] did not exist.

“Expenditure” includes a depreciation loss. The exemption in s CW 17 does not apply to relocation payments [see 330.40] or payments for overtime meals [see 330.42].

Employers are responsible for determining the appropriate tax treatment of allowances and payments paid to employees. Employers are entitled to make a reasonable estimate of the amount of expenditure likely to be incurred by an employee or group of employees.

Section CW 17 exempts an amount that would, in the absence of the exemption, be taxable. A reimbursing allowance (ie an amount paid regularly to an employee along with salary and wages) could constitute taxable income, hence the need for the specific exemption when the allowance simply reimburses the employee for costs that are incurred by employees in the course of their employment. However, one off reimbursements would not have the hallmarks of income, and do not require s CW 17 to exempt the amount from tax (ie it was never income in the first instance). However, such an amount could come within the definition of expenditure on account of an employee.

“Expenditure on account of an employee” means a payment made by an employer relating to expenditure incurred by an employee [s CE 5; see 1300.15]. Expenditure on account of an employee can be either:

(a) A reimbursement by the employer of expenditure that an employee has paid; or

(b) An account which is in the employee’s name that is paid by the employer.

Certain deductions are not allowed when calculating assessable income. The most likely ones to apply in relation to allowances and payments on account of employees are the limitations on capital, and private and domestic expenditure. Therefore, an allowance paid by an employer or a payment on account of an employee, can be paid tax free when the allowance or payment reimburses an employee for expenditure which is or would be incurred in deriving the employee’s income, provided the allowance or payment does not reimburse capital expenditure or expenditure of a private or domestic nature.

Only allowances paid to employees can be paid tax free. An “employee” is defined in s YA 1 for this purpose as any person who receives or is entitled to receive a PAYE income payment, which is a payment of salary or wages, an extra pay, or a schedular payment. For this purpose the definition of employee also includes a shareholder-employee of a close company, to which the rules in s RD 3(2) to (4) apply.

Therefore, people who do not receive a PAYE income payment are not eligible to rely on s CW 17 to treat the allowance as tax free.

330.25 Reimbursing allowances versus benefiting allowances

Reimbursing allowances confer no monetary gain on the employee and, therefore, are treated as exempt from taxation [ss CW 17, CW 17B, CW 17C, CW 18]. A benefiting allowance is regarded for tax purposes as
additional salary or wages [s CE 1(a)], and the value of the allowance for any pay period must be added to
the employee’s salary or wages and PAYE tax deducted from the total wages paid including the allowance.

330.30 Transport allowances [s CW 18]
The basic principle is that the normal cost of travel between a taxpayer’s home and their fixed place of work
is not deductible in calculating net income, or, alternatively, that an allowance granted to an employee for
the cost of travel between home and work at normal times and in normal circumstances is taxable in the hands
of the employee as it is reimbursing private expenditure [330.20].

It has been held by the Courts that travelling between home and work is not undertaken to enable the taxpayer
to exercise the vocation but “for the purpose of neutralising the effect of departure from the place of business,
for private purposes, on the previous evening. In other words, the object of the journeys, both morning and
evening, is not to enable a person to do work, but to live away from it” Newsom v Robertson (Inspector of
Taxes) [1952] 2 All ER 728 (EWCA).

However, an allowance received by an employee from an employer to cover the employee’s additional
transport costs is exempt income to the extent to which the employee incurs the costs:
(a) In connection with their employment; and
(b) For the employer’s benefit or convenience [s CW 18].

Additional transport costs are the costs to an employee of travelling between their home and place of work,
where those costs are more than would ordinarily be expected. The costs must be attributable to one or more
of the following factors:
(a) The day or time of day when the work duties are performed.

Example 1:
An employee normally working in the daytime when public transport is running may be required to work late at night
when public transport is not available, and is obliged to use a private car. An allowance to cover the car costs in excess
of normal public transport costs could be tax exempt.

Example 2:
An employee normally working a five day week may occasionally be required by the employer to work an extra day,
say, at stocktaking time, at the weekend. An allowance to cover the additional transport costs on that extra day could
be exempt.

(b) The need to transport any goods, or material for use or disposal in the course of the employee’s work.

Example:
An employee, normally using public transport, may be required by the employer to use a private car to pick up some
material or tools of trade on the way to work for use in the employer’s business. In such a case an allowance paid by
the employer for the additional cost of running the car over and above the normal travel costs would be exempt.

(c) The requirement to fulfil a statutory obligation.

(d) A temporary change in the employee’s place of work while in the same employment.

Example:
An employee normally stationed in one town is seconded to a position in a branch of the employer in another town and
paid an allowance to cover the costs of travelling home and back on weekends. The additional cost of travel, compared
with the employee’s costs of normal travel between home and workplace in the home town, would be exempt. The
word “temporary” is not defined, but in practice a period of up to one year would be accepted without question.

(e) Any other condition of the employee’s work. Here again the additional costs of travel imposed on the
employee must be for the benefit or convenience of the employer, if the allowance is to be exempt.

(f) The absence of an adequate public passenger transport service that operates fixed routes and a
regular timetable for the employee’s place of work. The exempt amount is the amount by which the
transport costs exceed $5 per day.
The absence of an adequate public transport service could be relevant in the case when the place of work is situated in a remote location (e.g., freezing works, airports, prisons, hotels). When this factor (of inadequate or no public transport) applies, a travelling allowance paid to reimburse an employee for the cost of travelling from home to work will be tax-exempt to the extent that the allowance does not exceed the surplus of the actual cost of the transport over $5 per day.

**Example:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount per day</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual transport costs</td>
<td>$7.25</td>
</tr>
<tr>
<td>Deemed normal cost</td>
<td>$5.00</td>
</tr>
<tr>
<td>Surplus</td>
<td>$2.25</td>
</tr>
<tr>
<td>Allowance paid</td>
<td>$8.50</td>
</tr>
</tbody>
</table>

The position for tax purposes is:

- **Tax-free allowance** $2.25 per day
- **Taxable allowance** $6.25 per day

In determining whether a particular public transport passenger system is “adequate”, factors to be taken into account should include:

(a) Distance of the workplace from the public passenger transport system;
(b) Adequacy of timetables; and
(c) Capacity of the public passenger transport service to cope with the volume of the employees requiring transport. Thus, if a company has 250 staff whom are required to commence work at 7:30 am in a remote area, and only one bus is scheduled to arrive at that particular place at the time, the public passenger transport system would clearly be inadequate. **TRA Case K15** (1988) 10 NZTC 196 centred around allowances paid to employees being exempt. The CIR submitted the allowance could not be considered exempt from tax as it was payable to all employees, regardless of whether they each incurred “additional transport costs”.

Often the distinction between a taxable and exempt allowance for transport costs can be a fine one. Within the broad parameters set in the ITA 2007, there are many shades of grey.

### 330.40 Relocation expenses

**[ss CW 17B, CX 19(1)(c); TAA, s 91AAR]**

Payments made by an employer to, or on behalf of, an employee who is required to move to a new location for work purposes are exempt from income tax and FBT if the following conditions are met:

(a) The amount paid does not exceed the actual cost of relocation;
(b) The expense is on the list of eligible relocation expenses (see below);
(c) The expenditure is incurred by the end of the tax year following the tax year in which the relocation occurred;
(d) The employee’s existing home is not within reasonable travelling distance of their workplace (unless the accommodation forms an integral part of their work); and
(e) The relocation is as a result of the employee:
   (i) Taking up new employment with a new employer;
   (ii) Taking up new duties at a new location with their existing employer; or
   (iii) Continuing in their current position but at a new location.

The exemption applies from the 2002-2003 income year.

See TIB vol 21:8 (October/November 2009), Part II, at 64-68 for further information.

1. **Eligible relocation expenses**

The eligible relocation expenses, as set out in Determination 09/04 [TIB vol 21:9 (December 2009), at 8-10], are:
(a) **Preparatory**
- Engaging a relocation consultant;
- A familiarisation trip to the new location immediately prior to relocation, for a maximum of seven days in the new location (this excludes travelling time between the old and new locations);
- Obtaining immigration assistance;
- Immigration and emigration applications;
- Health checks, tests and immunisations necessary for immigration or emigration;
- Any documentation and police and other agency checks required as a result of the relocation;
- Obtaining advice on the taxation and superannuation implications of relocating and of obtaining assistance in meeting any additional tax reporting/return requirements that arise from relocating.

(b) **Transportation**
- Removal and transport of household effects (including insurance, insurance excesses and taxes);
- Moving “tools of trade” (including insurance, insurance excesses and taxes);
- Moving other personal items such as cars, boats or trailers (including insurance, insurance excesses and taxes);
- Cleaning and fumigation associated with the removal, transportation and storage of household effects;
- Excess baggage charges arising from the transportation of household and other personal effects and “tools of trade”;
- Customs clearance and other costs associated with complying with New Zealand Customs regulations and other regulatory requirements that arise when transferring household and personal effects and “tools of trade” from the old to the new location;
- Transport to get to the new location (such as, but not limited to, air fares and car rental costs) using a direct route, and meals and accommodation en route;
- Relocating pets, including quarantining and boarding fees;
- Hiring a replacement vehicle while awaiting transportation and clearance of the employee’s own vehicle to the new location. If the employee does not have a vehicle in transit, the cost is limited to a maximum of one month’s hire;
- A trip to tidy up affairs after relocation.

(c) **Property**
- Exiting or breaking existing accommodation leases and similar contracts;
- Selling an existing home and acquiring a new dwelling; in particular:
  - Real estate commissions;
  - Advertising and auctioning;
  - Legal and conveyancing fees and disbursements;
  - Loan application fees;
  - Mortgage early repayment loan application fees;
  - Valuation costs;
  - LIM and building reports (or similar);
  - Any stamp duty; and
  - Penalty interest charges for breaking a fixed term loan.
  (But not any loss in capital value of the existing home);
- Finding accommodation, whether to rent or to purchase, in the new location (but not bonds, refundable or otherwise);
- Hiring household and/or personal effects for the new location, while awaiting transportation of related property to the new location;
- Storage of household or personal effects left at the old location, for (subject to the overall time limit) up to two years;
- Storage of household or personal effects once they have arrived in the new location, for up to three months, or until the employee finds a permanent home, whichever is sooner;
Employee Allowances

- Disposing of household/personal effects and similar assets at the previous location (but not capital losses);
- Conversion of any electrical appliances because of voltage differences between the old and new locations;
- Disconnection and connection fees for, respectively, the old and new residences in relation to utilities (such as power and gas) and telecommunication services (such as telephone, internet and television);
- Accommodation or value of employer provided accommodation once the employee has arrived in the new location, for up to three months after arrival;
- Cleaning and fumigation of old and new residences;
- Utility, rates, insurance and maintenance for the employee’s previous residence for up to one year if, despite reasonable efforts, it cannot be sold or rented, or if the property is rented by the employee, it cannot feasibly be rented to someone else (for example, because the relocation is for a short period).

(d) **Individuals, dependants and miscellaneous**

- Language training for the employee necessary for the relocation (up to 12 months after relocation);
- Redirecting mail;
- Disposal of investments, including superannuation and insurance policies, (but not any reduction in the value thereof), that cannot be held or continued because of the relocation;
- Charges for currency exchange on actual eligible relocation expenses incurred;
- Travel/health insurance while relocating;
- Additional childcare costs that arise as a result of a relocation giving rise to a temporary household rearrangement, for up to three months from the time of relocation;
- School uniform items that need to be replaced because of the relocation;
- Private school application fees if an employee’s children were enrolled in private schools in the previous location or where there is no alternative to private schools in the new location;
- Cancelling professional and club memberships;
- Other costs directly arising from relocation, up to $500 in aggregate.

Taxpayers wishing to add items to the list can apply to:

LTS Manager, Technical Standards
National Office
Inland Revenue
PO Box 2198
Wellington

The application should include the applicant’s details, the nature of the change being sought, and information to support the change.

(2) **Backdated adjustments**

Because the exemption has been back-dated to the start of the 2002-2003 income year, some taxpayers will be entitled to a credit for tax paid on past payments that should have been exempt. Taxpayers can request Inland Revenue to amend a past assessment under s 113 of the TAA [see 60.70, 60.120]. Employers who have grossed up a payment to compensate an employee for the tax impost can obtain a credit for the overpaid PAYE by requesting an adjustment to the applicable employer monthly schedule, which Inland Revenue will do on receipt of the appropriate documentation.

Payments made by a company to compensate employees for financial disadvantages suffered as a result of transferring to a new locality were not of the nature of being a simple reimbursement of expenses or losses incurred by an employee, and were not exempt under s CW 17: *Shell New Zealand Ltd v Commissioner of Inland Revenue* (1994) 16 NZTC 11,303 (CA).
330.42  Overtime meal payments and allowances [ss CW 17C, CX 19(1)(c)]

1) Overtime meal payments
When an employer pays for a meal for an employee who is working overtime, the payment is exempt income of the employee. This applies whether the payment is made directly to the employee or on the employee’s behalf. The exemption applies only if:
(a) The employee has worked at least two hours’ overtime on the day of the meal; and
(b) Either:
   (i) The employee’s employment agreement provides for pay for overtime hours worked; or
   (ii) The employer has an established policy or practice of paying for overtime meals.

“Overtime” means time worked for an employer on a day beyond the person’s ordinary hours of work as set out in their employment agreement.

There is no monetary limit or restriction on what can be included in a “meal”, therefore it could, for example, include beer or wine.

2) Sustenance allowance
When an employer pays a sustenance allowance to an employee, the payment is exempt income of the employee if:
(a) The employee works a minimum of seven hours on the day for which the allowance is paid;
(b) Their employment requires them to work outdoors and away from their employment base for most of the day, and to undertake a long period of physical activity in travelling through a neighbourhood or district on foot or by bicycle;
(c) It is not practicable for the employer to provide sufficient sustenance on the day for the period when the employee is working outdoors;
(d) The allowance recognises the arduous physical nature of the employee’s work, and that the employer would normally provide tea, coffee, water, or similar refreshments at the employment base in the course of their business; and
(e) The employer has an established policy or practice of paying a sustenance allowance.

Note: This exemption was introduced primarily for the benefit of postal workers who are required to carry mail bags, and therefore do not have the capacity to carry food and drinks with them. They need to purchase these items along their mail route to ensure they maintain their energy levels while delivering mail. The allowance recognises that these employees do not have access to employer-provided drink facilities that are normally available to employees at little or no cost.

3) General
For both overtime meal payments and sustenance allowances, the amount paid by the employer must be the actual cost to the employee or a reasonable estimate of the expenditure likely to be incurred by the employee or a group of employees for whom the payment is made. In the case of overtime meals, if actual cost is being reimbursed, documentation is required for meals over $20.

See TIB vol 21:8 (October/November 2009), Part II, at 68-69 for further information.

The exemptions apply from the 2002-2003 income year.

330.45  Accommodation, board, and lodging assessable to employee
[ss CE 1(1B), RA 5, RD 3, RD 5, RD 6]

When an employee is provided with free or subsidised board or lodging, or the use of a house or living premises, or the use of part of a house or living premises, in connection with their employment, the market value of that non-cash benefit is treated as income [s CE 1(1B)]. Under s RD 6 the value of this benefit is treated as accruing from day to day and must be included in the employee’s salary or wages for the relevant
Employee Allowances

pay period before deducting PAYE. If a cash allowance is paid instead, the allowance is taxable under s CE 1(1)(a) and subject to PAYE under ss RA 5 and RD 3.

Accommodation benefits provided to employees are excluded from fringe benefit tax under s CX 28 [see 540.200].

The market value of an accommodation benefit may be determined by the employer. However, in the case of a dispute with Inland Revenue, the market value determined by the CIR is the relevant value. Given this, getting agreement with the CIR as to the value of the benefits as early as possible should be considered. While this may not necessarily bind the CIR (unless a binding ruling is sought), it does give some degree of comfort should the issue of value arise.

Where the employee’s duties necessitate travelling temporarily away from home or the usual place of residence, and board and lodging, or a cash payment in lieu is made by the employer, the board and lodging or the cash payment take on more of a reimbursing nature than an income nature and as such are not liable for tax [see 330.20].

An employer may provide a house allowance in either of the following ways:

(a) By supplying a free house valued at, say, $200 per week in addition to the weekly cash wage of, say, $1,000 per week; or

(b) By paying a gross wage of $1,200 per week and receiving back by way of rent from the employee the sum of $200 per week.

For taxation purposes the position is as follows:

(a) In the first case the employer is entitled to a deduction from business income for the wages paid in cash at the rate of $1,000 per week plus the upkeep of the house in the form of insurance, rates, interest, repairs and maintenance, depreciation, etc. This applies even when the outgoings on the house plus the cash wage exceed $1,200 per week. The employee is liable for income tax on $1,200 per week.

(b) In the second case, the employer may claim a deduction of the gross wage of $1,200 per week, but must return the net rent derived from the employee (ie the $200 per week less outgoings, as above).

The employee’s position is the same in both cases. PAYE should be deducted on a gross payment of $1,200 per week.

In TRA Case F114 (1984) 6 NZTC 60,111, the taxpayer and his wife operated a bus company and purchased a suitable property from which to operate their business. The property included a dwelling-house and the taxpayer and his wife lent the company $37,000 interest free to upgrade the dwelling for their own use. The CIR assessed the taxpayer for half the rental value of the property. The TRA allowed the objection and held:

(a) The dwelling-house was purchased for the convenient operation of the company. The house was provided for the taxpayer’s position with the company.

(b) The value of the interest free loan equated to the rental value of the house.

Where a shareholder of a company lived above one of the company’s warehouses the shareholder did not gain monetary remuneration in the form of accommodation as the area above the warehouse was not fitted out for residential purposes and was not so used by the shareholder: TRA Case R5 (1994) 16 NZTC 6,027.

330.50 Valuing accommodation, board, and lodging

The full market value of a house or accommodation provided to an employee is taxed [s CE 1(1B)], regardless of whether the employee would have selected that standard of accommodation had he or she been free to choose independently of the requirements of the position. However, in practice the test is what would be a fair value to the employee having regard to this and other factors. Where other factors are thought to be significant, the question of the figure on which PAYE is to be deducted should be taken up with the CIR. The CIR has the right to determine the value of that benefit.

When a shareholder-employee occupies a dwelling, bought or built by the company, and pays less than the full rental value or no rent at all, it is necessary to consider whether there is a taxable benefit. To ensure
uniformity a calculation is made and is used as a starting point to discuss what is a fair rental. This calculation is a guide only.

(1) **The position with shareholder-employees of close companies**

<table>
<thead>
<tr>
<th>Non-farm dwelling</th>
<th>Farm dwelling</th>
</tr>
</thead>
<tbody>
<tr>
<td>The total of:</td>
<td>Three quarters of the total of:</td>
</tr>
<tr>
<td>3% of cost price, including cost of land</td>
<td>3% of cost price, excluding cost of land</td>
</tr>
<tr>
<td>Depreciation at normal rates</td>
<td>Depreciation at normal rates</td>
</tr>
<tr>
<td>Repairs and maintenance, average or estimated</td>
<td>Repairs and maintenance, average or estimated</td>
</tr>
<tr>
<td>Rates and insurance</td>
<td>Insurance</td>
</tr>
</tbody>
</table>

The cost of the land and the rates payable are not included in the calculation for farm dwellings as the area occupied by the dwelling is, usually, small compared with the area of the farm, and the amount apportioned would be trivial. Other factors to be considered include:

(a) Remoteness as it affects additional capital cost, as well as rental value;
(b) Age of the dwelling;
(c) If the house was on the land when purchased, it may be a more substantial one than was required;
(d) Any other reason peculiar to the community; and
(e) Whether the taxpayer maintains another house.

<table>
<thead>
<tr>
<th>Example:</th>
</tr>
</thead>
<tbody>
<tr>
<td>A shareholder-employee of a farming company occupies, rent free, a dwelling owned by the company and built for $20,000 (excluding land). Insurance is $40 and estimated cost of annual repairs and maintenance is $60. The calculation would give a rental value of:</td>
</tr>
<tr>
<td>3% of $20,000</td>
</tr>
<tr>
<td>Depreciation at 2%</td>
</tr>
<tr>
<td>Estimated repairs</td>
</tr>
<tr>
<td>Insurance</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Less one quarter</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Less remoteness (say)</td>
</tr>
<tr>
<td>Rental value</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>The shareholder-employee is assessed for income tax on the annual rental value of $425. The company receives a deduction for the actual expenses and depreciation on the dwelling.</td>
</tr>
</tbody>
</table>

If the deduction allowed to the company exceeds the rental value assessed to the shareholder, the excess is not treated as a “dividend” to the shareholder unless the value of the benefit enjoyed by the shareholder exceeds the value of any consideration provided by the shareholder for such benefit. In *TRA Case F114* (1984) 6 NZTC 60,111 it was held that where a company provided a house to a shareholder-employee there was no assessable benefit as the employee provided the company with an interest-free loan. The value of the interest free loan to the company relative to the rental value of the house was such as to leave no surplus benefit to be taxed. However, if this were not the case and there was a benefit to the shareholder in excess of the taxable rental value, then dividend implications will need to be considered.

(2) **Calculating a fair rental value**

When a senior executive in a widely-held company is provided with a substantial dwelling, the following calculation is used as a starting point to calculate a fair rental value:
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(a) Three per cent of cost including land;
(b) Five per cent of cost of furniture (if provided);
(c) Repairs and maintenance, estimated or average;
(d) Rates and insurance.

The following factors will also be considered before a decision is reached as to the fair rental value:

(a) Has the executive any say in the choice of accommodation?
(b) Does the position held in the company require the employee to occupy far more pretentious premises than would have otherwise been selected for personal use?
(c) Is the employee generally required to entertain and perform other duties in the house for the benefit of the company?
(d) Is the employee required to reside in a remote area?
(e) Does the employee maintain another residence?

330.55 Accommodation supplied at major construction sites

For many years the CIR placed a nil value on the “on site” accommodation supplied to workers at some major construction sites. The reasons for this are historical but related mainly to the poor type of accommodation supplied and the general remoteness of the sites. With the improvement in the type of accommodation now being supplied, the general improvement in transportation, and the siting of some major projects near to urban areas the CIR is of the view that there is no longer any justification for not including the value of this accommodation in their income. Construction site employees are now assessed for the value of the accommodation supplied and the exemption no longer applies. The amount to be assessed is equal to the allowance paid under the various contract agreements where accommodation is not supplied [see PIB 160 (March 1987)].

330.65 Motor vehicle allowances

The payment of reimbursement or allowances to staff should be distinguished from the supply of a motor vehicle for private purposes, the latter being subject to fringe benefit tax. The following rules apply:

(a) Company employees who are not shareholders may be entitled to a maximum distance allowance for business usage based on Inland Revenue distance rates. Alternatively, a proportion of actual expenses and depreciation applicable to full running of the vehicle is calculated and deductible to the business.

(b) In qualifying and non-qualifying companies the use of vehicles by shareholder-employees is subject to fringe benefit tax, but the revenue costs of providing the benefit is deductible along with the fringe benefit tax.

(c) A sole proprietor or a partner in a partnership who provides a vehicle to the business may be entitled to a maximum distance allowance for business usage based on Inland Revenue distance rates. Alternatively, a proportion of actual expenses and depreciation applicable to full running of the vehicle is calculated and deductible to the business. The expenditure and depreciation related to the non-business use of vehicles is not allowed.

Travelling allowances for the cost of normal travel between home and place of work are assessable.

330.70 Clothing, laundry, dirt, and tool allowances

Allowances paid to employees required to work in dirty, unhygienic, damp, dusty, hot, or cold conditions, etc, and allowances paid to employees required to work in confined spaces, employees handling acids, or employees required to wear clogs or gumboots, etc should be distinguished from allowances to reimburse employees for expenditure incurred in obtaining the necessary gear and clothing to perform the work. The former is a benefiting allowance and taxable, the latter is a reimbursement and is exempt. The following allowances can be understood using this yardstick:

(a) Allowances paid to employees required to perform special duties such as spray painting, welding, higher duties, in charge, etc are assessable.
Employee Allowances

330.75

(b) Under some contracts employers are required to pay a “clothing and dirt allowance”. The payment combines a benefit allowance (dirt allowance) and a reimbursing allowance (clothing allowance) in one sum. One half is regarded as taxable and the other half is exempt.

(c) An allowance granted to employees to supply their own boots and gumboots is exempt, but the allowance paid for being required to work in gumboots is assessable income.

(d) A laundry allowance is exempt.

(e) Allowances paid to employees who are required to provide and work in uniforms do not confer a monetary gain to the recipient in so far as uniforms are not ordinary civilian wear and the recipient still has to maintain a personal wardrobe.

(f) A “plain clothes allowance” paid to a plain clothes police officer is partially benefiting and partially reimbursing.

(g) A clothing allowance paid to clergy for the repairs and renewals of normal everyday clerical clothing (as distinct from robes such as cassock and surplice worn in the church and in conducting funeral services) is assessable.

(h) A commercial traveller’s apparel allowance is assessable.

(i) A clothing allowance paid by stock and station agents to employees required to attend stock sales regularly is assessable.

(j) Replacement of protective clothing (used personally) necessary in the production of income is exempt.

(k) A tool and overall allowance is exempt.

(l) An allowance paid to chainsaw operators who supply their own chainsaws is considered to be an exempt reimbursement [see 330.20].

330.75 Examples of reimbursing allowances

The following are examples of reimbursing allowances which are not assessable:

(a) A country or camp allowance may be a benefitting allowance or a reimbursing allowance, depending on the circumstances. Cases have shown that there are circumstances when the duration of the contract (in one instance two years), is such that a single person at least must be regarded as a matter of fact to have severed an association with the previous town, and the CIR has laid down the following rules as a guide:

(i) A country allowance could be regarded as reimbursing and exempt to a married person working away from home. If the employee gives up that home and moves the spouse [see 960.10] and family to the new area the allowance is exempt only when working away from the new home.

(ii) The allowance may be regarded as exempt to an unmarried taxpayer who is temporarily away from the normal town of residence. When a period of absence ceases to be temporary is largely a matter of fact in each case. To provide a working basis, the CIR considers that where a case of the allowance being paid after more than 12 weeks in one place comes to notice, it should be discussed with the employer to ascertain the facts. It must not be inferred that the allowance is to be treated as taxable after 12 weeks, but merely that after 12 weeks the position should be reviewed to ascertain the facts.

(b) Parliamentary reporters’ allowance.

(c) A broken shift allowance is a reimbursement for additional expenses incurred.

(d) Meal money and tea money allowance.

(e) Free accommodation paid to married seamen and widowers at sea maintaining a home ashore.
Employee Allowances

(f) Victualling allowance paid to married seamen and widowers maintaining a home ashore, while ashore on duty whether in home port or otherwise. But victualling allowance paid under the Holidays Act 1981 while on leave is assessable in all cases.

(g) “Out of port” allowances paid to tally clerks, foremen stevedores, foremen, timekeepers, and shipwrights when working away from their home port. The allowance is treated as a reimbursing allowance, and therefore exempt from taxation, as it recognises the necessity for the recipient incurring extraordinary expenses, and that there is no financial gain to the recipient. It applies only to persons employed on a permanent basis and not to ordinary waterfront employees or harbour board employees.

(h) Tanker allowance:
   (i) Crew members are paid non-taxable allowances.
   (ii) Ships’ officers: a tanker allowance is built into the monthly salaries paid to officers and the total is taxed.

(i) Office allowance paid by firms to representatives who live away from branches and conduct a lot of the firm’s business from their homes. The allowance is a reimbursement of the cost of providing office room in their homes and is therefore not assessable.

(j) Night shift allowance for packaging and associated printing employees is exempt from tax, as is the payment made to night workers to recompense transport costs incurred after hours of normal public transport in excess of normal public transport costs.

(k) Location allowances paid to consultants on overseas aid programmes.

(l) When a farmer employs a shepherd or musterer on a permanent basis, or a permanent farm hand on shepherding or mustering duties and the employee is required to supply dogs, horse, and saddlery any allowances received from the employer are exempt.

(m) Rewards received from the police or the Customs Service for information leading to the apprehension of offenders are not taxable unless received as employees of the department.

330.80 Examples of benefiting allowances

The following are examples of benefiting allowances which are assessable to employees:

(a) Locality allowance, which is additional remuneration to employees required to reside in remote areas and is not paid for the purpose of offsetting additional expenses. This allowance is not to be confused with the country or camp allowance paid to employees temporarily required to reside away from their usual place of residence.

(b) Sailors are entitled to be found both while aboard ship and while temporarily ashore in the employ of the shipping company. The benefit ashore may be in the nature of food supplied by the ship’s galley while the ship is in dock, a specific cash allowance, or the cost of hotel accounts paid by the shipping company. The full value of this allowance is exempt in the case of a married or widowed sailor maintaining a home ashore, and partially exempt in the case of an unmarried sailor.

(c) The assessed value of free house, coal, meat, etc supplied to employees.

(d) Standby allowances, waiting time allowances, and travelling time allowances.

(e) Allowance paid to drivers who collect cash is additional remuneration for the responsibility involved in handling cash.

(f) Cashiers and tellers’ risk allowance paid by trading banks. Where the trading bank does not require tellers to make up losses and where the allowance is paid it is for incentive or pay differential reasons. Consequently, when paid by a trading bank, it is a benefit allowance and is accordingly assessable to the recipient.

(g) Keep and accommodation allowances to shearsers is assessable.

(h) Share buying privileges to staff are included in the term monetary remuneration.
Employee Allowances

(i) Where an employer pays income tax or life insurance premiums on behalf of an employee these payments constitute salary or wages and are assessable accordingly.

(j) Examination bonuses on passing various examinations are assessable notwithstanding they are paid partly in consideration of the tutorial and examination fees and books in studying for and passing the examination.

(k) Salvage money paid to the volunteer crew who had already been paid by the harbour board at ordinary overtime rates was assessable, even though it was a voluntary payment: *Naismith v Commissioner of Inland Revenue* (1981) 5 NZTC 61,046, (1981) 4 TRNZ 300 (HC).

330.85 Gratuities and retiring allowances received [s CE 1]

Amounts derived in connection with employment [s CE 1] includes gratuities, which may be classified as either an extra pay or as salary and wages. It is immaterial whether there was an express or implied agreement to pay the amount, or whether the payment was merely a spontaneous gesture on the part of the donor, provided the payment was for or in relation (whether directly or indirectly) to employment or service. A non-cash benefit is subject to the fringe benefit tax regime.

As from 30 November 1992 redundancy payments are assessable income in full with no distinction between lump sum and instalment payments [s CE 1(f)]. However, a tax credit of up to $3,600 was available for payments received between 1 April 2008 and 30 September 2011 under subpart ML [see 1395.90].

As from 1 January 1994 all retirement payments paid by an employer to an employee are taxable to the employee. This applies whether the payment is made in one lump sum or in instalments. The payments are extra pays, so they are liable for an initial PAYE deduction at the extra pay rate but are later included in the person’s annual income tax return and assessed in the ordinary way along with other income. The Social Security Act 1964 includes retiring allowances in the definition of “average income” for the purpose of calculating the high income earner. It applies to all retiring allowances paid on stand-down. People earning above the average wage who receive a retiring allowance are required to look to savings before being granted income support. However, retiring allowances are not taken into account for the purpose of determining the rate of payment of any benefit.

Amounts received as tips are assessable income of the recipient. Although they are given voluntarily, they are given in relation to services rendered, however negligible the service may be. How the tips are taxed depends on whether they are received directly or by way of a service charge. Where the tips are made by the customer direct to the employee, or where the payments are placed in a common pool for the benefit of a number of employees, the employees should return the payments in their annual income tax returns.

Where a service charge is added to the customer’s bill and later paid by the employer to the employee, the employer should treat the payment to the employee as additional wages for the week and deduct PAYE at the appropriate rate. To be deductible by the payer, the tips must represent expenditure necessarily incurred in carrying on a business for the purpose of deriving assessable income and could be expected to be considered as travelling or entertainment expenses.

330.90 Deduction for retiring allowance paid to employee [s DC 1]

A deduction is allowed to a person carrying on a business for any lump sum payment made as a bonus, gratuity, or retiring allowance to an employee of that business when the employee retires. Section DC 1 supplements the general permission, and overrides the capital limitation.

The deduction is allowed when the employee has ceased to be employed as a result of redundancy or loss of office or employment or other similar circumstances. The deduction is also allowed when the former employee cannot be re-employed in any seasonal employment or service of the taxpayer through the occurrence of similar circumstances.

Any lump sum payment made when the employee ceases to be employed or the former employee is unable to be re-employed, is deemed to be a retiring allowance paid on the occasion of retirement. That employee or former employee is deemed to have retired on that date. No deduction is available under s DC 1 to the...
extent that the taxpayer has accepted a liability to make a lump sum payment as part of the purchase of the business [see 1300.25].
Chapter 335

Employment Relationship

335.10 Independent contractor or employee relationship
The question of whether a person is in business or an employee arises because an employee is not permitted any deductions in deriving assessable income. An independent contractor is someone who is in business and is therefore allowed deductions for expenditure and losses [s DA 1]. If the person is not in business, payments received are subject to tax deductions at source in the form of PAYE and schedular payments [see 1080 PAYE]. Accident compensation levy obligations might also arise. The question usually only arises with sole proprietor type operations.

The application of tax law relies on the terms “contract of service” and “contract for services”, but does not define them. Therefore, the meanings depend on the general contract law developed by the Courts and any statutes that apply to a particular kind of work. A person has the same employment status for tax purposes as under general law. If Inland Revenue needs to determine a worker’s status, it uses the current general law [see Inland Revenue Booklet Self-Employed or an Employee? (IR336)].

335.20 Tests of the employment relationship
The following is an extract of the main points from the CIR’s interpretation guideline on whether a person is an employee or an independent contractor [Interpretation Guideline IG 11/01].

The common law distinguishes between contracts of service and contracts for services. A contract of service means there is an employer-employee relationship; a contract for services means there is a principal-independent contractor relationship. At common law, the Courts have developed various tests to determine whether there is a contract of service or a contract for services. The case law shows that the main tests are the intention, control, independence, fundamental and integration tests. These tests are explained below.

The tax obligations of a taxpayer with respect to payments received for work done by the taxpayer depend on his or her employment status (ie whether the taxpayer is an employee or an independent contractor). Employment status has the following consequences for tax purposes:

- Payments to employees from their employer must have PAYE deducted at source;
- Employees cannot register for GST or charge GST for services they supply as employees;
- Independent contractors may deduct certain expenses incurred in deriving assessable income;
- Independent contractors must account to Inland Revenue for tax and accident compensation earner and employee premiums for themselves and any employees; and
- Independent contractors must meet all the requirements of the Goods and Services Tax Act 1985 if the services they supply are in the course of a taxable activity and they are registered (or liable to register) for GST.

Taxpayers cannot change their employment status (or the resulting tax implications of that status) merely by calling themselves independent contractors when they are essentially still employees.

Although there is no exhaustive list of considerations, the tests discussed below (established by the case law) provide useful guidance as to the factors that are to be considered in determining whether someone is engaged as an employee or contractor. These are relevant tests to be considered but, as the cases demonstrate, they may not all be relevant to any one particular enquiry.

It is important in each case to determine employment status by balancing all the circumstances of the relationship between the parties. Often there will be competing factors that support differing conclusions as
to whether someone is an employee or an independent contractor. Applying the tests to the facts of a case requires an objective weighing of the various relevant factors to determine the true nature of the relationship. Often the terms of the relationship between two persons will be recorded in a written agreement; though this is not necessarily the case. If there is a written agreement, the first step is to analyse its terms and conditions. However, it is important to note that the nature of the relationship may change over time (e.g., a person takes on more duties), and this may not be reflected in the written agreement. Changes in regulations and work practices may also cause the employment status of some workers to change. Or, it could simply be that the written agreement does not accurately reflect how the relationship works in practice. It is necessary to consider how the parties actually work together when determining the type of employment relationship between them.

The two leading cases on determining employment status are *Bryson v Three Foot Six Ltd* [2005] NZSC 34, [2005] 3 NZLR 721 (SC) and *TNT Worldwide Express (New Zealand) Ltd v Cunningham* [1993] 3 NZLR 681, (1993) 15 NZTC 10,234 (CA) [see 335.30].

(1) **Intention of the parties test**

The intention of the parties test looks at the intentions of each party to the agreement regarding the nature of the relationship. The description given to a relationship by the parties to the contract is a strong, but not conclusive indication of the type of relationship that exists. The fact that a written contract states that a person is an employee or an independent contractor may indicate the intention of the parties, but it is not determinative: *Bryson v Three Foot Six Ltd*. If the actual circumstances point to an employment relationship, then simply labelling it an independent contract relationship will not alter the true position.

The taxation arrangements between the parties may be relevant when establishing their intentions. For example, if the person engaged to perform the services is paid at a set rate at regular intervals and PAYE is deducted, this may support the view that the parties intended a contract of service.

In some circumstances industry practice may be relevant when determining the intention of the parties. In *Bryson* the Supreme Court agreed with the Employment Court’s statement that industry practice could be relevant when considering the parties’ intention, but that it was not determinative.

(2) **Control test**

The control test looks at the degree of control the employer or principal exerts over the work an employee or contractor is to do and the manner in which it is to be done. The greater the extent to which the principal or employer specifies work content, hours and methods and can supervise and regulate a person, the more likely it is that the person is an employee.

This test used to be considered as the deciding factor, but this is no longer the case. In *TNT Worldwide Express (New Zealand) Ltd v Cunningham* [see 335.30], the Court of Appeal emphasised that control is only one of several factors relevant to the interpretation of the contract.

(3) **Independence test**

The independence test was not mentioned in *Bryson* or *TNT*. The independence test is simply the inverse of the control test. A high level of independence on the part of an employee or a contractor is inconsistent with a high level of control by an employer or a principal.

A person generally has a high level of independence if they:

- Work for multiple people or clients (but the fact the person works for only one person or client does not necessarily mean the person is an employee);
- Work from their own premises;
- Supply their own (specialised) tools or equipment;
- Have direct responsibility for the profits and risks of the business;
- Hire or fire whomever they wish to help them do the job;
- Advertise and invoice for the work;
- Supply the equipment, premises and materials used;
- Pay or account for taxes and government and professional levies.
**Employment Relationship**

(4) **Fundamental test**

The fundamental test is also sometimes described as the “business test” or the “economic reality test”. The fundamental test looks at factors such as:

- Whether the type of business or the nature of the job justifies or requires using an independent contractor;
- The behaviour of the parties before and after entering into the contract;
- Whether there is a time limit for completing a specific project;
- Whether the worker can be dismissed;
- Who is responsible for correcting sub-standard work;
- Who is legally liable if the job goes wrong.

Usually, an independent contractor agrees to be responsible for their work. An independent contractor cannot usually be “dismissed”, although the contract can be terminated if it is broken.

(5) **Integration test**

The integration test is really whether the person is part and parcel of the organisation and not whether the work is necessary for the running of the business. According to the integration test, a job is likely to be done by an employee if it is:

- Integral to the business organisation;
- The type of work commonly done by “employees”;
- Continuous (not a “one-off” or accessory operation);
- For the benefit of the business rather than for the benefit of the worker.

### 335.30 Cases on the employment relationship

The Supreme Court considered the distinction between employee and independent contractor in *Bryson v Three Foot Six Ltd* [2005] 3 NZLR 721, (2005) 22 NZTC 19,242 (SC). Mr Bryson was seconded from Weta Workshop to Three Foot Six Ltd to work in its miniatures unit as a temporary model maker. After two weeks he was offered a permanent position as an on-set model technician working on the production of The Lord of the Rings films. He was not given a written employment agreement or work contract when he began. For the first few weeks he received training. Six months later, Three Foot Six Ltd supplied a written contract (“crew deal memo”) for all of its crew, which refers throughout to “Contractor” and “Independent Contractor”. Approximately 18 months after he commenced work with Three Foot Six, Mr Bryson was made redundant. He alleged unjustifiable dismissal, but could only bring such a claim if he was found to have been an employee.

In the Employment Court, Shaw J found that the real nature of the employment was that of a contract of service. There was no evidence that Mr Bryson was acting as a separate business entity. He had arrived by transfer from Weta and took up the position he was offered. It was not a short-term position and he had no other employment while he was with Three Foot Six. He had model making skills but no relevant experience for his new position. He required six weeks training. He could not be said to have been contracting his skills. Much of the crew deal memo read like a contract of service. Three Foot Six closely controlled his work. He was expected to work regular hours and was treated as an employee, being paid for downtime.

The Employment Court decision was overturned by the Court of Appeal, which found that Shaw J had not placed sufficient weight on contractual intent and industry practice. However, on appeal the Supreme Court concurred with the Employment Court decision that Mr Bryson was an employee, not a contractor. The Supreme Court held that:

(a) The Employment Court correctly directed itself in accordance with s 6 Employment Relations Act 2000 (which defines “employee”).

(b) It was open to the Employment Court to conclude that the crew deal memo did not give any reliable indication of the real nature of the relationship.
Employment Relationship

(c) The Employment Court correctly used the control, integration and “fundamental” tests, in conjunction with other relevant matters, to determine the real nature of the relationship, as directed by s 6(2) Employment Relations Act 2000.

(d) The finding by the Employment Court that industry practice was not helpful in establishing the common intention of Mr Bryson and Three Foot Six Ltd, because Mr Bryson’s working conditions were not typical of the industry, was not a legal error.

(e) The Employment Court was correct in concluding that evidence about invoicing of Mr Bryson’s services, and of the fact that Inland Revenue had not challenged his categorisation as an independent contractor, did not support the respondent’s case that his real status was independent contractor.

(f) On the basis of the evidence as a whole it was open to the Employment Court to find, for the reasons it gave, that the real nature of the relationship between Mr Bryson and Three Foot Six Ltd was one of employment. Mr Bryson was not able to delegate his work. His job was effectively full-time. On the evidence, the Employment Court could take the view that Mr Bryson was not in business on his own account, taking the profits and running the risks of a sole trader, despite being required by Three Foot Six to issue invoices to them and comply with taxation requirements on that basis. The evidence about the industry did not seem to describe relationships similar to that of Mr Bryson with Three Foot Six.

In *TNT Worldwide Express (New Zealand) Ltd v Cunningham* [1993] 3 NZLR 681, (1993) 15 NZTC 10,234 (CA), it was held that an owner-driver courier for TNT was an employee and not self-employed. *TNT Worldwide Express* was not a tax case, but it has tax implications because the general law determines employment status for tax purposes.

Employers who attempt to opt out of their PAYE obligations by putting staff on contract should ensure those staff actually meet the tests outlined above and are in fact contractors. Otherwise, employers may face claims for PAYE not deducted plus additional tax if the staff are actually employees.

Inland Revenue’s policy that real estate agents paid by commission were employees and not independent contractors was upheld because it was stated as such in the legislation under which the real estate industry operated: *Challenge Realty Ltd v Commissioner of Inland Revenue* [1990] 3 NZLR 42, (1990) 12 NZTC 7,212 (CA); *Challenge Realty Ltd v Commissioner of Inland Revenue* (1990) 12 NZTC 7,022 (HC). Consequently, the Real Estate Agents Act 1976 was amended by inserting s 51A to allow these persons to be treated as independent contractors as from 1 April 1991. Where deductions for expenses are claimed Inland Revenue needs to see a written agreement between the parties expressly acknowledging the independent contractor relationship. GST implications are also likely to arise when the taxable supply threshold is exceeded, which also requires tax invoices to exist for the payment of commission, and adjustments to be made when any private asset is brought into the business. Commission payments are subject to withholding tax, a practice upheld by the High Court in *Wendell and Associates Ltd v Commissioner of Inland Revenue* (1986) 8 NZTC 5,155, (1986) 9 TRNZ 721 (HC), for real estate agent commissions.

The West Australian Supreme Court in *GH Teede Pty Ltd v Commissioner of State Taxation (Western Australia)* (1985) 16 ATR 647, 85 ATC 4447 (WASC) held the relationship between the taxpayer real estate agency and its real estate salespeople to be that of employer and employee. Commissions paid were treated as wages despite the fact that little, if any, control and supervision were exercised over the manner in which the agents did their work.

Whether a national broadcasting personality was an independent contractor or an employee of the Broadcasting Corporation was discussed by Judge Barber before holding that the taxpayer (on the facts), was an independent contractor. Eighty-five per cent of the taxpayers income came from Broadcasting Corporation sources and its real estate salespeople to be that of employer and employee. Commissions paid were treated as wages despite the fact that little, if any, control and supervision were exercised over the manner in which the agents did their work.

A private company claimed a person to be neither an employee nor a subcontractor. He had joined the firm for a trial period prior to becoming a shareholder. He was paid monthly and received car petrol expenses and payment of private telephone expenses from the company. He had no shareholding, no position of responsibility, nor any partnership agreement with the company. He was held to be an employee for purposes
of PAYE deductions, his work being held to be an integral part of the business: TRA Case J7 (1987) 9 NZTC 1,044.

A council rubbish tip operator was held to be not an employee. The fact that the contract could only be assigned or sublet on conditions approved by the council was held not to be uncommon. There was a bona fide mutual intention that the operator be an independent contractor. He invoiced fortnightly for services and maintained his own proper records of materials sold and accounted (including GST thereon) to the council accordingly: TRA Case K72 (1988) 10 NZTC 578.

An underwater inspection engineer considering diving for offshore oil drilling operators, who would only contract with companies in order to avoid industrial award and employer obligations, formed a company which then contracted to do work for the operator. Inland Revenue claimed the legal arrangements were a sham and treated the company’s income as being income of the individual personally. Inland Revenue was held to be incorrect, the TRA stating it was impossible to go behind the contracts or to pretend the company did not exist. The individual was an employee of the company and not of the operator: TRA Case K10 (1988) 10 NZTC 63.

Mechanics were held on the facts by the High Court to be independent contractors even although almost all work was provided to them by the objector company. Relevant factors were the following: each mechanic was GST registered and paid accident compensation levies; tools were provided by and maintained at the expense of the mechanics; no restrictions existed in relation to their hours worked; no holiday or sick pay entitlements existed; no union membership was taken; and the mechanics had personal keys and paid rent for work areas. In relation to work, each mechanic turned down work offered, fees were paid on invoice rendered by the mechanic on an hourly rate basis (a time for a job having been negotiated in advance between the company and the mechanic). Any remedial work was performed at the expense of the mechanics: Enterprise Cars Ltd v Commissioner of Inland Revenue (1988) 10 NZTC 5,126 (HC).

A mechanic who was re-engaged as an independent contractor by a company of which he was previously an employee, had his status of independent contractor confirmed in Coro Trading Ltd v Commissioner of Inland Revenue (1996) 17 NZTC 12,495 (HC). This decision was reached despite the fact that from the customers’ point of view there had been no change in how they were billed, and that the company maintained some control over how the contractor conducted his business in order to ensure consistency. Critical factors in the decision were:

(a) He was responsible for organising his own workload;
(b) He took the financial risk of earning a business income;
(c) He lost the entitlement to regular hours and fringe benefits such as holiday pay, sick leave, and superannuation;
(d) He could accept or decline whatever work was offered to him;
(e) His income was proportionate to his effort; and
(f) He fulfilled his financial and taxation obligations to Inland Revenue as an independent contractor.

Arrangements made by a forestry company when changing employment arrangements with a bulldozer driver employed for 13 years were held thereafter to constitute the driver an independent contractor: TRA Case L107 (1989) 11 NZTC 1,597.

A useful summary of the tests to be applied for resolving the employee/independent contractor position is stated in TRA Case L39 (1989) 11 NZTC 1,241, at 1,245-1,247.

Where an employment agency introduced specialist personnel to do work for its clients, it was held that the employment agency was not required to make PAYE deductions from payments made by the employment agency to the specialists as the specialists were not employees of the employment agency: TRA Case M122 (1990) 15 TRNZ 308.

A 19-year-old man in his fourth year of an apprenticeship, working for another person in order for hours worked to count towards the total hours needed to complete an apprenticeship, was an employee and not an independent contractor: TRA Case P48 (1992) 16 TRNZ 887.
In *TRA Case S62* (1996) 17 NZTC 7,393, the taxpayer and two other employees of a company who entered into a contract to do work for their employer outside their normal hours of work were held to be independent contractors with regard to the contract work. The contract work was carried out some distance from their normal place of work as employees. There was little control by the company over when or how the contract work was done. No holiday or sick pay was provided by the company in relation to the contract work and no replacement labour provided during holidays or periods of sickness.

In *TRA Case T18* (1997) 18 NZTC 8,108, the TRA held that a person employed to manage a sports club was an employee and not an independent contractor. Reasons given for the decision were:

(a) The manager was under the firm control of the club committee — he was not free to manage the club as he saw fit;

(b) The manager was an integral part of the club’s operation;

(c) The manager did not provide the tools or equipment required to perform his task;

(d) The manager undertook no real business risk; and

(e) The manager’s base salary was paid, in regular and identical weekly payments, regardless of his effectiveness in the job.

The TRA noted that it would be almost impossible to structure the manager as an independent contractor.

In *TRA Case X17* (2006) 22 NZTC 12,224, the TRA held that a relief courier driver was a casual employee and not an independent contractor.

In *TRA Case Z10* (2009) 24 NZTC 14,113, drivers engaged by a car rental company to move cars from one location to another were held to be independent contractors, not employees. Among other things, the contract between the company and the individual drivers provided for: work to be offered on an “as available” basis, made the drivers responsible for paying any insurance excesses on claims, and required drivers to acknowledge that the agreement was not an employment contract and that no holiday pay was payable. Drivers were paid fixed rates for relocating vehicles, depending on distance, and were required to provide invoices to the company for work done and their GST number if they were registered. Judge Barber considered that in many ways the issue in the case was borderline and that therefore the intention of the parties (which was accepted as genuine and not a sham), should prevail. The contract between the drivers and the company specifically stated that the drivers were independent contractors and the parties had dealt with each other in a manner consistent with the drivers being independent contractors. The integration of the drivers into the business was limited. The independence and control tests do not support the drivers being casual employees. The drivers were exposed to some degree of legal and financial risks. Consistent with them being in business on their own account, they could delegate work to others, were free to work for other people or themselves, could refuse to accept relocation work at any time, and could make themselves unavailable at any time for any length of time.
Chapter 340

Employee Share Purchase Schemes

340.10 Employee share purchases [ss DC 12, CE 2(7)]

A company may provide financial assistance to an employee by way of an interest-free loan to enable the purchase or subscription for shares in the company. Where such financial assistance is provided, the company is entitled to a notional deduction for interest in respect of the loan. This notional deduction is in addition to any deduction for interest that the company may in fact have incurred on capital borrowed for the purpose of making the loan.

An employee share purchase scheme can apply to all classes of employees, including part-time and seasonal workers. A director cannot participate and neither can any persons who are associated with each other and who between them hold 10 per cent or more of the issued capital of the company. However, there is nothing to prevent an employee who has joined a scheme from subsequently being appointed a director.

The amount of the notional deduction is the interest which the employing company would have paid in the income year if all of the following applied:

(a) The money lent to the employee had been borrowed by the company at 10 per cent per annum;
(b) The interest on the notional loan was calculated with monthly rests; and
(c) Repayments by the employee had been repayments of the notional loan by the company.

The notional deduction is allowed for five years following the date on which the loan to the employee was made.

If the employing company is part of a group of companies, it is not necessary for the shares that are issued to the employee to be shares in the employing company. They may, instead, be shares in another company within the group. Where this occurs, the section applies as if the issued shares were shares in the employing company.

To qualify for the notional interest deduction, the scheme must satisfy a long list of criteria and must be approved by the CIR [see 340.20].

The value of the benefit to an employee through taking up shares in an employee share purchase scheme made available under these rules is nil. Any gain cannot be assessed to the employee as employment income [s CE 2(7)].

340.20 Criteria for approval of employee share purchase schemes [ss DC 13, DC 14, DC 15]

A company must obtain the CIR’s approval of the scheme in order to qualify for the notional interest deduction. When seeking approval, the company should send a copy of the rules and/or trust deed to the CIR.

The CIR is bound to approve an employee share purchase scheme submitted by any company provided all of the following criteria are satisfied:

(a) Share purchase:
   (i) The shares must be fully paid ordinary shares that rank equally with existing ordinary voting shares in the company;
Employee Share Purchase Schemes

(ii) The cost to employees of shares made available for purchase or subscription must not exceed market price at the date of purchase or subscription. The cost can be below market price [s DC 15(1)];

(iii) The aggregate amount of purchases which may be made by any employee within a three year period must not exceed $2,340 [s DC 13(2)].

(b) Employee eligibility:

(i) Every full-time permanent employee must be eligible to participate in the scheme on an equal basis with every other full-time permanent employee. Where the scheme is available to part-time employees or to seasonal employees, they must be eligible to participate on an equal basis with every other part-time employee, or every other seasonal employee;

(ii) Any minimum period of employment or service which may be required before a full-time permanent employee becomes eligible to participate in the scheme is not to exceed three years. In the case of other employees, any minimum period of service is not to exceed a cumulative period that is the equivalent of three years’ full-time service [s DC 13(3)].

(c) Loans:

(i) Loans to employees for the purchase of shares must be free of all interest and other charges;

(ii) Where it is a requirement that loans made under the scheme to any employee shall be of a minimum amount, the minimum amount is not to exceed $624;

(iii) The repayment of loans by employees is to be by regular instalments at intervals of not more than one month over a period of not less than three years and not more than five years from the date of the loan;

(iv) Any employee may however elect to repay all or any part of the loan prior to the due date for repayment, but the shares may not be released until after the end of the restrictive period [s DC 13(4)].

(d) During the restrictive period:

(i) The shares are to be held in trust for the employee;

(ii) The trustee must pay to the employee all dividends on the shares, and the dividends are not to be applied by the trustee towards repayment of any loans owing under the scheme or towards any other debts owing to the company;

(iii) Any employee, for whom shares are held in trust, must be precluded from charging or disposing of all or any of their rights or interests in the shares [s DC 13(5)].

(e) Employee hardship: Where the trustee is satisfied that continuing to participate in the scheme would result in the employee suffering serious hardship, the trustee and the employee must be permitted under the scheme to agree as follows:

(i) To vary the terms of the loan repayments; or

(ii) That the employee be allowed to withdraw from the scheme [s DC 13(6)].

(f) Withdrawal from the scheme: Employees must be entitled to withdraw from the scheme on giving three months’ written notice to the trustee.

(g) On expiry of the restrictive period:

(i) On repayment of loans at the expiry of three years or other restrictive period, the shares are to be transferred to the employee by the trustee or, at the employee’s option, the shares are to be purchased by the trustee from the employee at the lesser of market value or cost price to the employee at the date of purchase;

(ii) On the death of an employee, the shares must be transferred to the trustee of the deceased employee’s estate, or, at the option of the trustee of the estate, the shares must be purchased...
Employee Share Purchase Schemes

by the trustee of the scheme at the lesser of market value or cost price to the employee. This is subject to repayment of any loans outstanding for the shares;

(iii) If the employee suffers accident, sickness, redundancy, or enters into retirement at normal retiring age, the shares are to be transferred to the employee, or at the option of the employee, they are to be purchased by the trustee at the lesser of market value or cost price to the employee. This is subject again to repayment of any loans outstanding on the shares. The words “or retirement of the employee at normal retiring age” enable an employee who retires within three years of taking up the shares to keep the shares instead of having to sell them back to the trustee.

The expression “normal retiring age” means:

• Not less than 60 years of age;
• Not less than 55 years of age in the case of a female employee who is entitled, by reason of a contract of employment entered into before 1 April 1978 with the employing company, to retire before attaining the age of 60 years; or
• Such earlier age as the CIR considers reasonable having regard to the nature of the employment or the general terms of employment in the business or the occupation of the employee.

(iv) On termination of employment: Other than for reasons of death, accident, sickness, redundancy or retirement at normal retiring age or on withdrawal from the scheme, the trustee is not to transfer to the employee any shares held on trust, but is to purchase the shares from the employee at the lesser of market value or the original cost price to the employee. This is subject to repayment of all loans outstanding for the shares [s DC 14].

340.30 Shares issued to employee at below market value [ss CE 1, CE 2, CE 6, CE 7, CZ 1]

(1) General rules

The income of an employee includes any benefit that the employee receives under a share purchase agreement [s CE 1]. However, the value of the benefit is nil where the benefit arises under a share purchase scheme that has been approved by the CIR under s DC 12 [see 340.10, 340.20, s CE 2(7)].

A “share purchase agreement” is defined in s CE 7 as “an agreement to sell or issue shares in a company to an employee that is entered into in connection with the employee’s employment or service, whether or not an employment relationship exists when the employee receives a benefit under the agreement”.

The term “share purchase agreement” does not include any agreement entered into before 19 July 1968 [s CZ 1]. Convertible notes are included in the term “share” [s CE 6(1)].

There are four circumstances under which a taxable benefit can arise:

(a) The employee acquires the shares;
(b) The employee disposes of rights to a non-associated person;
(c) An associated person of the employee acquires the shares; or
(d) An associated person of the employee disposes of rights to a non-associated person.

(2) Employee acquires shares

If an employee acquires shares under a share purchase agreement, the assessable income of the employee includes the difference between the market value of the shares as at the date of acquisition and the consideration (if any) paid or payable for them. The benefit is taxable in the year in which the employee acquires the shares. [s CE 2(2)].
Employee Share Purchase Schemes

Example:

1 February X1  Employee granted option to acquire 1,000 shares for $1,000. The market value of the shares at this date is $1,000.
1 May X1  Employee exercises the option and pays $1,000 for the shares. On this date the shares have a market value of $1,500.
Assessable benefit  $500. ($1,500 value less $1,000 paid.)
When assessable  Year ended 31 March X2. (tax year in which shares acquired.)

There is one exception to the imposition of tax where the employee acquires shares under a share purchase agreement. If the agreement provides unconditionally that, if the employee dies or ends his or her employment, the shares must be transferred back to the employer or to the person from whom they were acquired either for no consideration or for an amount no greater than the amount paid by the employee for the shares, the value of any benefit under the share purchase agreement is deemed to be nil [s CE 2(6)].

(3)  Employee disposes of rights to non-associate

If, instead of acquiring shares, the employee disposes of the rights under the share purchase agreement to a non-associated person, the assessable income of the employee includes the amount received for the rights. The benefit is taxable in the year in which the employee disposes of the rights [s CE 2(3)].

Example:

1 February X1  Employee granted option to acquire 1,000 shares for $1,000. The market value of the shares at this date is $1,000.
1 May X1  Employee disposes of the rights under the agreement to a non-associated person for $1,100. At this date the market value of the shares is $1,500.
Assessable benefit  $1,100 (amount received for the rights.)
When assessable  Year ended 31 March X2. (tax year in which rights disposed of.)

(4)  Associate acquires shares

If an associated person of the employee acquires the shares, the employee’s assessable income includes the difference between the market value of the shares on the date of acquisition and the amount paid for them. If the difference is negative, the value of the benefit is zero. The benefit is taxable in the tax year in which the associated person acquires the shares [s CE 2(4)].

This provision encompasses a series of any number of associated person transactions that culminate in an acquisition of the shares by an associated person.

“Associated persons” is defined in Subpart YB and includes (among other things) two persons who are “relatives” [see 70 ASSOCIATED PERSONS AND RELATIVES].
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(5) **Associated person disposes of rights to non-associate**

If an associated person of an employee disposes of rights under a share purchase agreement to a non-associated person, the employee’s assessable income includes the consideration for the disposal. The benefit is taxable in the year in which the rights are disposed of to an unassociated person [s CE 2(5)].

**Example:**

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 February X1</td>
<td>Employee granted option to acquire 1,000 shares for $1,000. The market value of</td>
</tr>
<tr>
<td></td>
<td>the shares at this date is $1,000.</td>
</tr>
<tr>
<td>1 May X1</td>
<td>Employee disposes of rights to his spouse [see 960.10] for $1,000.</td>
</tr>
<tr>
<td>1 December X1</td>
<td>Spouse sells the rights to her brother for $1,500.</td>
</tr>
<tr>
<td>1 February X2</td>
<td>Brother sells the rights to an unrelated friend for $2,000. The market value of</td>
</tr>
<tr>
<td></td>
<td>the shares at this date is $3,000.</td>
</tr>
<tr>
<td></td>
<td><strong>Assessable benefit</strong></td>
</tr>
<tr>
<td></td>
<td>$2,000. (the amount of the consideration received by the brother-in-law.)</td>
</tr>
<tr>
<td></td>
<td><strong>When assessable</strong></td>
</tr>
<tr>
<td></td>
<td>Year ended 31 March X2. (tax year in which rights sold to a non-associated person.)</td>
</tr>
</tbody>
</table>

As can be seen in the above examples, where the employee disposes of the rights under a share purchase agreement to an associated person, the employee is taxable on:

(a) The exercise of the rights by that (or any other) associated person; or
(b) The sale of the rights by that (or any other) associated person to a non-associated person.

Income arising from the exercise of an employee share option is not subject to tax — to the extent that the gain relates to overseas employment. A pro-rata apportionment (on a time basis) is required where the employment, to which the share option relates, was performed both in New Zealand and offshore [see 370.35].

### 340.40 Valuing benefits arising under a share purchase agreement

[ss CE 3, CE 4]

Employees are taxable on benefits received under a share purchase agreement. Where the benefit arises from the exercise by the employee (or an associated person) of a right to acquire shares, the taxable value of the benefit is the difference between the amount paid for the shares and their market value as at the date of acquisition [see 340.30].

It is therefore necessary to be able to ascertain the market value of the shares. If the share purchase agreement imposes restrictions on the employee’s ability to deal with the shares, those restrictions will impact on the market value of the shares.

However, in determining the value of any benefit, the effect of any restrictions contained in the agreement as to the disposal of the shares are ignored unless the restrictions apply:

(a) For a period of eight years or more from the end of the tax year in which the benefit is received;
(b) For a period ending not earlier than the date of death of the taxpayer; or
(c) For either of the periods mentioned above, but subject only to the exception that, on the taxpayer ceasing employment prior to the expiry of either of those periods, all or any of the shares must unconditionally be transferred to the employer or to the person from whom they were acquired, either without consideration or for a consideration that is not more than the taxpayer paid for them.

**Example 1:**

If an agreement provided that the taxpayer could not sell or otherwise deal with the shares acquired under the agreement for a period of five years this restriction would be ignored in valuing the shares. But if the period was 10 years, the restriction would need to be taken into account in valuing the shares.

Where a share purchase agreement does not restrict an employee from transferring shares under a relationship agreement, but the transferee under the relationship agreement remains restricted as if he or she was the employee, the restriction is deemed to apply to the employee.
Example 2:
A share purchase agreement provides that:
(a) Employees are not able to dispose of shares for a period of 10 years other than by way of relationship agreement; and
(b) Shares acquired under a relationship agreement are not able to be disposed of for a period of 10 years from the date on which they were first acquired by the employee.

If an employee acquired shares and, after four years, disposed of them to their spouse [see 960.10] under a relationship agreement, the spouse would be precluded from disposing of the shares for a further six years. The combined 10-year restriction is sufficient for it to be taken into account in valuing the benefit.

The CIR may make an equitable adjustment at any time to the value of a benefit previously assessed where that value is reduced by a restriction or other condition that was not taken into account when the benefit was originally valued.
Chapter 350

Entertainment Expenditure

350.10 Business entertainment deductibility overview [s DD 1]

The business entertainment rules, forming the basis of the rules in the ITA 2007, first applied from 1 April 1995. The rules applying from 1 April 1995 replaced previous rules restricting the deductibility of business entertainment expenditure, which came into effect on 1 April 1993. These rules were not well understood and caused much confusion in practice. The rules as introduced from 1 April 1995 are discussed in some detail in TIB vol 6:12 (May 1995) at 14-19.

The underlying policy for these rules is that business expenditure giving significant private benefits should not be fully deductible. This policy is reflected in s DD 1(1) which states that subpart DD applies when, in deriving income, a person incurs expenditure on entertainment that provides both a private and business benefit.

The rules are based on the premise that all business entertainment expenditure of the type set out in the expenditure limitation rule in s DD 2 is denied a deduction, except for 50 per cent of that expenditure, if that amount would have been deductible under the general permission. The deductibility rules for the purpose of subpart DD are expressed to override the general permission — effectively making the subpart a complete code governing the deductibility of business entertainment expenditure of the type set out in s DD 2.

350.20 Business entertainment definitions [s DD 11]

The entertainment deductibility rules contain the following definitions.

“Business” includes any recurrent income-earning activity.

“Business contacts” includes clients, customers, shareholders, other financiers and suppliers of the taxpayer, or of an associated person. For a taxpayer in a partnership it does not include other partners in the partnership.

“Business premises” means the normal business premises or a temporary workplace of the taxpayer or of an associated person. It excludes premises or a workplace established principally for the purposes of enjoying entertainment.

350.30 Expenditure to which the limitation rules applies [s DD 2]

The types of entertainment expenditure to which the limitation rule in s DD 2 applies is set out in ss DD 2(2) to DD 2(6).

(1) Corporate boxes

The limitation rule applies to expenditure on corporate boxes, corporate marquees or tents, and other exclusive areas (whether temporary or permanent) at:

(a) Cultural, sporting, or other recreational events; or

(b) Activities occurring away from the person’s business premises.
The limitation rule also applies to tickets or other rights of entry to such boxes or other areas and the cost of food and drink incidental to this entertainment.

The limitation rule only applies to expenditure incurred on a corporate box during an event of the type stated under (a) and (b) above.

(2) **Holiday accommodation**

The limitation rule applies to expenditure on accommodation in a holiday home, time-share apartment, or similar leisure venue. The cost of food and drink incidental to this form of entertainment is also included. Accommodation which is merely incidental to business activities or employment duties is excluded.

The rule limits deductibility to expenditure on accommodation in a holiday home, not expenditure on a holiday home, as contrasted to expenditure on pleasure craft.

(3) **Pleasure craft**

The limitation applies to expenditure on yachts or other pleasure craft. The cost of food and drink incidental to this form of entertainment is also included.

(4) **Entertainment off premises**

The limitation rule applies to expenditure on food and drink that a person provides off their business premises.

(5) **Entertainment on premises**

The limitation rule applies to expenditure on food and drink that a person provides on their business premises at a party, reception, celebration meal, or other similar social function. It also includes expenditure on food and drink consumed in an area of the premises that at the time is reserved for senior employees to use and is not open to all the person’s employees working in the premises.

Light refreshments, such as morning tea, that are not provided in an area reserved for senior staff, are excluded in all cases, as the expenditure incurred in providing tea, coffee and other light refreshment is not brought into the entertainment limitation rules, unless provided at a party, reception, celebration meal or similar social function.

Light refreshments provided in an area specifically reserved for senior staff is excluded from the limitation rule under s DD 4(3)(b) when provided as part of the employee’s employment duties. For example, the costs of a morning tea provided to senior managers during a meeting in the executive dining room are fully deductible [see 350.50]. Otherwise, refreshment provided in such reserved areas is always subject to the 50 per cent limit on deductibility.

(6) **Meaning of expenditure for the purposes the above entertainment expenditure classes**

Expenditure includes any incidental expenditure on such matters as waiting staff, hireage of crockery, glassware or utensils, and music or other entertainment.

For corporate boxes, corporate holiday homes, and pleasure craft, expenditure includes any deduction for depreciation, or for a lease premium, and any deduction for running costs, maintenance and similar matters.

**350.40 Reimbursement and apportionment** [s DD 10]

A person is treated as incurring expenditure on entertainment described in s DD 2 if the person pays an allowance or reimburses an employee for that expenditure, and the allowance or reimbursement is exempt from tax under s CW 17. For example, when an employee takes a client out for lunch and is reimbursed by the employer, or an employee receives an allowance for such expenditure, the cost of that allowance is 50 per cent deductible to the employer. Thus, it is not possible to avoid the entertainment rules by paying a reimbursing allowance to an employee rather than incurring the cost directly.

**Note:** The exclusions to the entertainment rules in ss DD 4, DD 5, DD 6, DD 7, and DD 8, apply also to allowances and reimbursements.
If a person incurs expenditure that relates only partly to the entertainment, the expenditure must be apportioned appropriately. For example, this may be the case with expenditure on a firm’s holiday home when it is used as a business planning retreat [s DD 2(3)(b)].

Example 1:
A business owns a yacht. 60% per cent of the time the yacht is available for use by the business. The rest of the time the yacht is chartered out. 60% per cent of the yacht’s costs are subject to the deductibility rules. The remainder is fully deductible.

Example 2:
A company sponsors a basketball team. In return the company gets the use of a corporate box on selected days. The cost of the sponsorship attributed to the corporate box is 50% per cent deductible; the remainder is fully deductible to the company. The value of the corporate box may be specified in the contract. If it is not specified, market value should be used.

350.50 When the limitation rules for entertainment expenditure do not apply [ss DD 3, DD 4, DD 5, DD 6, DD 7, DD 8]

The limitation rule in s DD 2 is either restricted or does not apply to deductions for the expenditure described in ss DD 4 to DD 8 (as set out below).

(1) Business travel expenditure [s DD 4(1)]

The limitation rule does not apply to expenditure on food or drink consumed by a person while travelling on business or for the purposes of their employment. An exception to the exclusion applies when:

(a) The travel is mainly for the purposes of enjoying entertainment; or
(b) The food and drink is consumed at a meal or function involving an existing or potential business contact as a guest; or
(c) The food and drink is consumed at a celebration meal, party, reception, or other similar social function.

Whether something is a “meal or function” or a “celebration meal, party, reception, or other similar social function” is a question of fact in each case. A “function” is some sort of meeting or get-together, such as Friday night drinks. It is something more than just a morning tea. Nor is it a “party or similar social function”. “Party” is not defined in the ITA 2007. Accordingly, the word takes its ordinary meaning. In ordinary language, a morning tea is not a “party”, nor is it a “reception, celebration meal, or similar social function”.

The examples below give an indication of the types of things included in these categories.

Example 1:
In the course of a week, a Palmerston North-based sales representative travels to Wanganui, New Plymouth, and Hawera, staying overnight in each place. The sales representative is accompanied to Wanganui and New Plymouth by a fellow employee, who has just started working for the company. The sales representative and trainee dine together. The sales representative travels to Hawera alone. The night the representative is in Hawera she dines alone. The cost of all these meals is fully deductible to the employer. The next week the sales representative travels to Napier, where she takes a client out for dinner. Because a business contact is a guest, the cost of both meals is 50% per cent deductible. The following week the sales representative travels to Gisborne, where she pays for dinner for a valued client and staff who are opening a new store. The cost is 50% per cent deductible, because the food and beverages are being consumed at a meal at which a business contact is a guest. The next day, the sales representative happens to be at another client’s premises at morning tea time. She buys savouries and cakes for morning tea for the staff. The expenditure is fully deductible, as a morning tea “shout” is not a “meal or other function”.

Example 2:
A person travels from Wellington to Auckland on business and takes a client out to dinner. The cost of both of the meals is 50 per cent deductible.

Example 3:
Company A is a subsidiary of Company B. An employee of Company A travels from Christchurch to Auckland on business with an employee of Company B. If the employee of Company B is a guest of the employee of Company A at a meal (i.e., the meal is paid for by Company A), the cost of the meal is 50 per cent deductible. If the employees pay for their own meals, the
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costs are fully deductible to their respective companies. This applies even if the companies are in a consolidated group of companies.

(2) Conference expenditure [s DD 4(2)]

The limitation rule does not apply to expenditure on light refreshments at a conference, educational course, or similar event. Food and drink consumed at such an event that lasts for at least four consecutive hours (excluding meal times), is also excluded from the limitation rule. However, the limitation rule will apply if the event is principally for the purposes of entertainment.

The event must involve the conveying of knowledge. Seminars and conventions therefore qualify for the exclusion, as do some meetings. The event must not be held principally for the purposes of entertainment. For example, a four-hour lunch cannot be recharacterised as a “conference”, because the principal purpose of the lunch is entertainment. Although the event must be at least four consecutive hours, excluding meal times, the four hours can include a morning or afternoon tea break.

Example 1:
A course on negotiating skills runs from 10 am to 3 pm. Lunch is provided and there is a lunch break from 12 noon to 1 pm. There are also two 10 minute coffee breaks at 11 am and 2 pm. The lunch is excluded from the limitation rule and the cost is fully deductible. The cost of providing the morning and afternoon tea is also fully deductible.

Example 2:
A training course on management techniques which lasts from 2 pm to 5 pm has afternoon tea provided. The cost of the afternoon tea is fully deductible to the taxpayer, whether the course is held on or off the business premises, and whether it lasts for four hours or more.

(3) Expenditure on relocation expenses, employees’ meals and sustenance allowances [s DD 4(3)]

The limitation rule does not apply to expenditure on an amount that is exempt income under ss CW 17B and CW 17C (which relate to relocation expenses, expenditure on overtime meals, and sustenance allowances). [See 330.40, 330.42.]

It also does not apply to expenditure on a light meal consumed as part of the employee’s employment in an area of the person’s business premises that at the time is reserved for senior employees and guests and is not open to all the person’s employees.

Example 1:
A shop attendant is required to work late on Friday night. He is paid an overtime meal allowance which is non-taxable. The cost of paying the allowance is fully deductible to the employer.

Example 2:
Every week, the unit managers of a company have a lunch-time meeting in a reserved portion of the employer’s premises. The light lunch of sandwiches and fruit is excluded from the limitation rule.

(4) Sponsorship expenditure [s DD 5(1)]

The limitation rule does not apply to entertainment expenditure if the entertainment is sponsored mainly to advertise or promote a person’s business, goods, or services to the public and none of the following people has a greater opportunity to enjoy the entertainment than the public generally:

(a) Business proprietors;
(b) Existing business contacts;
(c) Employees of the proprietor; or
(d) Anyone associated with any of the above.

Example 1:
A soccer club arranges a sponsorship deal with a local engineering company. The engineering company pays for the team’s uniforms, which have the sponsor’s name on them, and provides food and beverages for the team and family members.
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immediately after the game. The cost of providing the uniforms is fully deductible to the engineering company as an advertising expense. The cost of providing the food and beverages is 50 per cent deductible as business contacts and employees of the sponsor attend, and it cannot be enjoyed by members of the public.

Example 2:
A rugby club has an arrangement with a local tavern under which the teams attend the tavern after their games and drinks are available at a special price to both the team and other patrons. The costs incurred in providing the drinks are fully deductible to the tavern as any member of the public is able to buy the drinks at the special price and the drinks, although provided at a discount price, are provided in an arm’s-length transaction.

(5) **Incidental costs of promotion** [s DD 5(2)]

The limitation rule does not apply to expenditure that is merely an incidental part of:

(a) A function open to the public and mainly held to advertise or promote a business, goods or services; or

(b) A trade display mainly held to advertise or promote a business, or goods or services.

Example 1:
A manufacturer promoting a new model of video camera holds a demonstration for home appliance dealers. The costs of providing drinks and nibbles at the display are fully deductible.

Example 2:
A law firm holds a free seminar on employment issues for clients one evening from 5.30 pm to 7.30 pm. The costs of providing drinks and nibbles at the end of the seminar are fully deductible.

(6) **Samples** [s DD 5(3)]

The limitation rule does not apply to a deduction for expenditure on entertainment that is provided as a sample for advertising or promotion purposes to persons who are not employees or their associates.

Example:
A winery gives away product samples at a wine and food festival; a brewery gives away beer at a launch of a new product; samples of a new brand of breakfast cereal are distributed to households. The costs incurred are fully deductible.

(7) **Entertainment for review** [s DD 5(4)]

Entertainment that is provided to a person reviewing that entertainment for a paper, magazine, book, or other medium is not subject to the limitation rule.

Example:
A food critic for a magazine has a meal at a restaurant and reviews that meal in her weekly food column. The cost of the dinner is fully deductible.

(8) **Entertainment as business** [s DD 6(1)]

The limitation rule does not apply to expenditure on entertainment provided by the person for market value or otherwise in an arm’s-length transaction in the ordinary course of the person’s business, if that business comprises providing one or more forms of entertainment listed in s DD 2 [see 350.30]. The use of the words “or otherwise in an arm’s-length transaction” recognises that entertainment may be provided in the ordinary course of business for less than market value.

(9) **Entertainment for charitable purposes** [s DD 6(2)]

The limitation rule does not apply to a deduction for expenditure on entertainment that a person provides to members of the public for charitable purposes.

Example:
A company provides food and beverages for a Christmas lunch for the homeless. The cost is fully deductible.
(10) **Entertainment outside New Zealand** [s DD 7]

The limitation rule does not apply to a deduction for expenditure on entertainment that is enjoyed or consumed outside New Zealand.

**Example:**
A New Zealand business holds its annual business-planning conference in Sydney. The costs are fully deductible. Some offshore entertainment is subject to fringe benefit tax (see below).

(11) **Entertainment that is income or fringe benefit** [s DD 8]

The limitation rule does not apply to expenditure on entertainment that is income to the person who consumes it, or is a fringe benefit subject to fringe benefit tax.

**Example 1:**
An employee receives an entertainment allowance that is fully taxable in their hands. The allowance is fully deductible to the employer.

**Example 2:**
As part of an incentive scheme, an employee is given a voucher for a restaurant meal. This is subject to FBT, and fully deductible to the employer.

### 350.60 Licensed premises operators

The following types of expenditure incurred by a licensed premises operator (a “licensee”) are fully deductible:

(a) Expenditure incurred on food or beverages, when a special offer of one of the following types is made in the ordinary course of business in an arm’s-length transaction with the general public:

(i) Happy hours, where a licensee offers drinks to customers at reduced prices during a particular time period;

(ii) Offers of free drinks or food, or both, on certain days or at certain times to customers or categories of customers selected from the general public;

(iii) Two meals offered to customers for the price of one; or

(iv) “Toss the boss” competitions, where for every drink purchased the customer can toss a coin and has the chance to win a free drink.

(b) An allowance paid to an employee (such as a bar manager) to cover the costs of that employee providing free drinks or food, or both to customers on the licensee’s business premises in the ordinary course of business. This does not apply if the free drinks or food are provided at a party or similar social function, or in a reserved area, or where the employee does not have an arm’s-length relationship with the customer.

The CIR considers that these types of expenditure are fully deductible because they are not entertainment and, even if they were, they would be excluded entertainment [see Public ruling BR Pub 04/02 (expired 1 April 2004) in TIB vol 16:3 (April 2004) at 4-7].

**Example 1:**
A licensee offers half-price drinks on St Patrick’s day to all patrons who wear a green hat. All other drinks are sold at full price. As the half-price drinks are provided to the green hat wearers in arm’s-length transactions in the ordinary course of the licensee’s business, the expenditure on the drinks is fully deductible to the licensee.

**Example 2:**
A licensee offers the next round of drinks free for a period of one hour on a Friday night to any customer who, following the purchase of a round, is able to score more than 10 by throwing a single dart at a dartboard. As the free rounds of drinks are available to all customers in arm’s-length transactions in the ordinary course of the licensee’s business, the expenditure on the drinks is fully deductible to the licensee.
## 350.70 Entertainment and fringe benefit tax [ss DD 9, CX 29]

Sections DD 2 to DD 8 override the FBT rules (ie if a benefit comprised of entertainment expenditure is subject to both FBT and the entertainment expenditure limitation rules, then the limitation rules apply). However, the FBT rules [specifically s CX 29] apply if an employee can choose when to receive or use the benefit, or does not receive or use the benefit in the course of their employment duties.

Section CX 25 states that the FBT rules will apply when:

(a) The employee does not receive or use the benefit in the course of their employment;
(b) The employee does not receive or use the benefit as a necessary consequence of their employment; and
(c) Either the employee may choose when to receive or use the benefit, or the entertainment is outside New Zealand.

**Example:**

FBT is payable on the value of a meal voucher awarded to an employee as part of an incentive scheme. The meal can be enjoyed at the employee’s discretion and is not enjoyed in the course of the employee’s employment duties.

If the benefit is subject to FBT, the general exclusion for benefits provided on the premises applies in determining whether entertainment provides a fringe benefit subject to fringe benefit tax.

Fringe benefit tax is also payable when a benefit that is entertainment is excluded from the limitation rule because it is enjoyed or consumed outside New Zealand and the benefit is not enjoyed or consumed in the course of employment duties. For example, as a sales incentive, staff who achieve certain targets receive an all-expenses paid trip to Hawaii to be taken at their discretion.

FBT may also be payable on the travel costs of an employee travelling to a corporate box, a yacht, or a holiday home. The FBT rules exclude from FBT any expenditure on an employee’s transport and accommodation when the travel is to enable the employee to perform the employee’s employment duties [s CX 20]. If the travel does not have a “business purpose” the expenditure is subject to FBT, unless s CX 20 applies.

**Example:**

Auckland employees are flown to Dunedin to watch a rugby test in the company’s corporate box at Carisbrook. The costs of the corporate box are subject to the entertainment deductibility rules, while the transport and accommodation costs are subject to FBT.

## 350.80 Entertainment and GST

A GST adjustment must be made of one-ninth of the non-deductible portion of entertainment expenditure (the GST-exclusive amount for GST registered persons). GST must be returned in the taxable period in which the income tax return is filed or is due to be filed (whichever is the earlier) [s 211(4) GSTA].
Chapter 370

Exempt and Excluded Income

370.10 Overview [ss BD 1, DA 1, DA 2]

Section BD 1 divides “income” into:

(a) Exempt income;
(b) Excluded income;
(c) Non-residents’ foreign-sourced income; and
(d) Assessable income.

In order for an amount to be “exempt income” it must first be “income”: Commissioner of Inland Revenue v Brierley [1990] 3 NZLR 303, (1990) 12 NZTC 7,184 (CA).

Amounts that are “exempt income” are located in subpart CW (Exempt income) or subpart CZ (Terminating provisions). Expenditure incurred in earning exempt income is unable to be deducted for tax purposes [s DA 2(3)].

Amounts that are “excluded income” are located in subpart CX (Excluded income) or subpart CZ (Terminating provisions).

Excluded income is not subject to income tax. However, it is taxed in other ways. For example, a fringe benefit is excluded income of an employee. However, it is subject to fringe benefit tax payable by the employer.

Expenditure incurred in earning excluded income is able to be deducted for tax purposes under s DA 1 provided that the deduction is not prohibited by one of the limitations contained in s DA 2, for example, an employee would not able to claim a deduction for any cost associated with the receipt of a fringe benefit as the deduction would be precluded by the employment limitation in s DA 2(4).

370.15 Exempt income

The following incomes are wholly or partially exempt from tax under the ITA 2007.

<table>
<thead>
<tr>
<th>Type</th>
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<tbody>
<tr>
<td>Accident Compensation Corporation</td>
<td>Exempt [s CW 64].</td>
</tr>
<tr>
<td>Accident or sickness benefits</td>
<td>Amounts received may be exempt [see 800 INSURANCE INDUSTRY, s CW 34].</td>
</tr>
<tr>
<td>Accident or sickness insurance</td>
<td>Amounts received may be exempt [see 820 INSURANCE POLICIES, s CW 34].</td>
</tr>
</tbody>
</table>
| Acquisition and disposition by a company of its shares | Income derived by a company from the disposition of its shares where the acquisition was deemed, under 67A(1) of the Companies Act 1993, not to result in cancellation of the share is exempt. Conversely, any
<table>
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<tr>
<th>Type</th>
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<tbody>
<tr>
<td>Agent Orange Trust</td>
<td>Income derived by the New Zealand Agent Orange Trust from the settlement fund awarded to the Trust by the United States District Court Eastern District of New York and accretions of income to that fund is exempt. The exemption applies only to that part of the trust’s income derived from the original settlement and accretions thereto. It does not apply to the income earned on any other funds held by the Trust. Distributions from the trust to beneficiaries are also exempt [s CW 33].</td>
</tr>
<tr>
<td>Aircraft operators</td>
<td>Non-resident aircraft operators are subject to New Zealand tax on all income which has a New Zealand source. Exceptions apply where a double tax agreement applies or where the specific provisions of s CW 56 apply. Section CW 56 provides that non-resident aircraft operators are exempt from tax where the CIR is satisfied that a New Zealand aircraft operator would be exempt from tax in the other country under the same circumstances. The CIR’s policy regarding the provision is set out in TIB vol 6:9 (February 1995) at 14 [s CW 56].</td>
</tr>
<tr>
<td>Armed forces and police allowances</td>
<td>Exempt if derived from operational areas [see 50 ARMED FORCES AND POLICE, s CW 23].</td>
</tr>
<tr>
<td>Canterbury earthquake relief</td>
<td>Accommodation and certain monetary remuneration [see 370.40 CANTERBURY EARTHQUAKE RELIEF, s CZ 23].</td>
</tr>
<tr>
<td>Charitable bequest</td>
<td>The income derived is exempt in certain circumstances [see 150 CHARITIES, s CW 43].</td>
</tr>
<tr>
<td>Charities business</td>
<td>The income derived is exempt in certain circumstances [see 150 CHARITIES, s CW 42].</td>
</tr>
<tr>
<td>Charities income</td>
<td>The income derived is exempt in certain circumstances [see 150 CHARITIES, s CW 42].</td>
</tr>
<tr>
<td>Child support and spousal maintenance</td>
<td>Exempt [s CW 32].</td>
</tr>
<tr>
<td>Community trusts</td>
<td>Income derived by a community trusts within the meaning of the Community Trusts Act 1999 is exempt [s CW 52].</td>
</tr>
<tr>
<td>Compensation for National Socialist persecution</td>
<td>Compensation is exempt [see 1120 PENSIONS AND ANNUITIES, s CW 34(1)(e)].</td>
</tr>
<tr>
<td>Compensation to ex-concentration camp prisoners</td>
<td>Compensation is exempt [s CW 34(1)(d)].</td>
</tr>
<tr>
<td>Compensation under the Crown Forest Assets Act 1989</td>
<td>Payments made to any person under the First schedule (except clause 3(b)) of the Crown Forests Act 1989 are exempt [s CW 34(1)(f)].</td>
</tr>
<tr>
<td>Compensation under Workers’ Compensation Act 1956</td>
<td>Amounts received may be exempt [s CW 34(1)(b)].</td>
</tr>
<tr>
<td>Cornwall Park Trust</td>
<td>Income derived is exempt [s CW 40(3)].</td>
</tr>
<tr>
<td>Criminal injuries payments</td>
<td>Amounts received are exempt [s CW 4(1)(c)].</td>
</tr>
<tr>
<td>Deferred service pay</td>
<td>Exempt [see 50 ARMED FORCES AND POLICE, s CW 24].</td>
</tr>
<tr>
<td>Disabled persons in sheltered employment</td>
<td>Income of a nominal amount derived by a disabled person for therapeutic activities undertaken in a sheltered workshop within the meaning of the</td>
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<tr>
<td>Exempt and Excluded Income</td>
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<td><strong>Type</strong></td>
<td><strong>Details</strong></td>
</tr>
<tr>
<td>Disabled Persons Employment Promotion Act 1960 or in a similar</td>
<td>Disabled Persons Employment Promotion Act 1960 or in a similar workshop is exempt. A “nominal amount” is anything up to and including an average of $50 per week over the tax year. If the average exceeds $50 per week, the payments are assessable in full. Any other income derived by the disabled person (e.g., from a trust or investments), is taxable in the normal way [ss CW 33(1)(d) and (2)].</td>
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<tr>
<td>workshop is exempt. A “nominal amount” is anything up to and</td>
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<td>including an average of $50 per week over the tax year. If the</td>
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<td>average exceeds $50 per week, the payments are assessable in full.</td>
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<tr>
<td>Any other income derived by the disabled person (e.g., from a trust</td>
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<td>or investments), is taxable in the normal way [ss CW 33(1)(d) and</td>
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<td>(2)].</td>
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<tr>
<td>Distributions from a trust set up by a community trust for charitable purposes</td>
<td>Distributions from a trust set up by a community trust for charitable purposes are exempt income. This exemption applies notwithstanding that the trust may since have been wound up and the proceeds distributed to the settlor community trust (thereby breaching the charitable status tests) provided that the distribution occurred in either the 2004-2005 or 2005-2006 tax year [s CZ 19].</td>
</tr>
<tr>
<td>Dividends derived by companies from foreign companies</td>
<td>A dividend derived by a company from a foreign company is exempt income. However, qualifications apply [see 850 INTERNATIONAL TAX REGIME, 270 DIVIDENDS, 670 IMPUTATION, s CW 9].</td>
</tr>
<tr>
<td>Dividends derived from New Zealand company from Niue-sourced income</td>
<td>Exempt under some circumstances [s CW 59(3)].</td>
</tr>
<tr>
<td>Earthquake Commission</td>
<td>Exempt [s CW 54].</td>
</tr>
<tr>
<td>Employee funeral expense trusts</td>
<td>Funds established in trust for the benefit of employees may be exempt [see 820.50, s CW 45].</td>
</tr>
<tr>
<td>Executive Council monetary annuity</td>
<td>Exempt if granted from the Crown Bank account by the Executive Council and not designated as being taxable [s CW 30].</td>
</tr>
<tr>
<td>Farm vendor finance bond or farm vendor mortgage income</td>
<td>50 per cent of interest from a farm vendor mortgage approved by the Rural Banking and Finance Corporation of New Zealand is exempt. The concessions are not available to companies, absentee, Māori authorities, public authorities, or trustees [s CW 6].</td>
</tr>
<tr>
<td>Foreign pensions</td>
<td>Certain foreign pensions are exempt [see 1120 PENSIONS AND ANNUITIES, s CW 28(1)(e)].</td>
</tr>
<tr>
<td>Foreign-sourced income of transitional residents</td>
<td>Certain types of foreign-sourced income is exempt from tax for up to 48 months following a person becoming a New Zealand resident [see 370.35].</td>
</tr>
<tr>
<td>Foreign superannuation fund withdrawals</td>
<td>Withdrawals from Australian superannuation funds are exempt from the Foreign Investment Fund (FIF) rules under some circumstances [see 850.130, s CW 29].</td>
</tr>
<tr>
<td>Friendly societies</td>
<td>The income derived is exempt except to the extent to which it is derived from a business carried on beyond its membership or from a company registered as an insurer under the Accident Insurance Act 1998 [s CW 44].</td>
</tr>
<tr>
<td>Gaming trusts</td>
<td>Gaming machine income of gaming trusts is exempt from 3 April 2006 provided that the trust is a licensed operator and the income is applied or distributed as required by the Gaming Act 2003 [s CW 48].</td>
</tr>
<tr>
<td>Governor-General</td>
<td>Salary and allowances are exempt [s CW 16].</td>
</tr>
<tr>
<td>Governor-General, Administrator in lieu of</td>
<td>Salary exempt [s CW 16].</td>
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</table>
### Exempt and Excluded Income

<table>
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<tr>
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<tbody>
<tr>
<td>Health research Council of NZ</td>
<td>Exempt [CW 64].</td>
</tr>
<tr>
<td>Herd improvement associations</td>
<td>Income of any herd improvement society or association if established mainly to promote the improvement of the standard of dairy cattle in New Zealand, is exempt; provided that no part of its funds is used or available to be used for the private pecuniary profit of any proprietor, member, or shareholder or any associated person [s CW 51].</td>
</tr>
<tr>
<td>Home-based services</td>
<td>Standard-cost household services provided by natural persons are exempt to the extent permitted under a determination issued by the CIR. The exemption also applies where the person may be treated under a determination as having incurred costs equal to, or in excess of, the income and the person elects not to claim any excess deductions. The activity must require the use of the taxpayer’s domestic accommodation and involve activities that commonly occur in a family. Taxpayers can, as an alternative, claim the actual costs incurred, in which case the income is not exempt [s CW 61; TAA, s 91AA, see 710.85].</td>
</tr>
<tr>
<td>Interest derived from tax-exempt source in foreign country</td>
<td>Interest derived from a country or territory outside New Zealand is exempt when two conditions are met. The first is that the recipient was not resident in New Zealand during the period for which the interest is payable. The second is that the interest is exempt from income tax (or a tax substantially the same as income tax) in the country of origin. It applies to people who have taken up residence in New Zealand and have subsequently received a payment of interest which accrued before they became resident in New Zealand. If that interest was exempt from tax in the country of origin it is exempt in New Zealand also. The taxpayer is put in the same position as would apply if the interest was uplifted immediately prior to taking up residence in New Zealand [s CW 7].</td>
</tr>
<tr>
<td>Interest on UK post-war credits</td>
<td>Interest on post-war credits payable under s 2 Income Tax (Repayment of Post-War Credits) Act 1959 of the United Kingdom Parliament is exempt in the UK and in New Zealand. The credits themselves were never taxable as they are not income [s CW 5].</td>
</tr>
<tr>
<td>Interest payable to non-residents</td>
<td>Payment made outside New Zealand to a non-resident being interest or a redemption payment on: (a) Money lent to the New Zealand Government; or (b) Money lent to a local or public authority for any non-commercial activity carried on in New Zealand, if exemption from income tax is given by the New Zealand Government [s CW 8].</td>
</tr>
<tr>
<td>International funds</td>
<td>Income derived by the trustee of the Niue International Trust Fund and by the trustee of the Tokelau International Trust Fund is exempt. Also, distributions by these trust funds is exempt income in the hands of the person receiving the distribution [s CW 59B].</td>
</tr>
<tr>
<td>International venture capital</td>
<td>Profits derived by qualifying foreign equity investors (“QFEI”) on the sale of shares in unlisted New Zealand resident companies that do not engage in certain prohibited activities are exempt [see 1000.60, s CW 13].</td>
</tr>
<tr>
<td>Jurors’ and witnesses’ fees</td>
<td>Fees paid by the Crown to jurors and witnesses (other than expert witnesses) are exempt. [s CW 26].</td>
</tr>
<tr>
<td>Kiwisaver contributions</td>
<td>Income derived by a natural person from an Australian complying superannuation scheme is exempt where it is contributed to a KiwiSaver scheme [s CW 29B].</td>
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<tr>
<td>Large budget screen production grants</td>
<td>Large budget screen production grants authorised by the New Zealand Film Commission paid to a company that is either resident in New Zealand or which has a permanent establishment in New Zealand in relation to a film or television production are exempt from tax [s CW 37].</td>
</tr>
<tr>
<td>Life insurance fund annuities</td>
<td>Annuities paid under a policy of life insurance offered or entered into in New Zealand by a life insurer, or offered or entered into outside New Zealand by a life insurer that is resident in New Zealand, are exempt [s CW 4].</td>
</tr>
<tr>
<td>Life insurers</td>
<td>Premiums derived and claims receivable under a policy of reinsurance [s CW 59C].</td>
</tr>
<tr>
<td>Local authorities</td>
<td>The income of a local authority is exempt from tax except for the following: (a) An amount received in trust; (b) An amount (other than rates) derived by a local authority from, (i) Any council-controlled organisation other than a council-controlled organisation operating a hospital as a charitable activity on behalf of the local authority, or (ii) Any energy company or port company or subsidiary of a port company; (c) An amount derived by a port operator to the extent to which it relates to a port related commercial undertaking. The Municipal Association was not an “incorporated instrument of Local Government in NZ” for purposes of the definition of “local authority”: Commissioner of Inland Revenue v Municipal Association of New Zealand Inc (1987) 9 NZTC 6,226 (CA) [s CW 39]. The Wellington Regional Stadium Trust was held not to be a “council-controlled organisation”. The fact that it had an operating surplus and was run in a businesslike manner did not mean that its purpose must be profit-making. Commissioner of Inland Revenue v Wellington Regional Stadium Trust (2005) 22 NZTC 19,445 (CA).</td>
</tr>
<tr>
<td>Maori land lease compensation</td>
<td>Payments of compensation, solatium payments, or payments to lessors for the purchase of leases, made to any person under the Maori Reserved Land Amendment Act 1997, are exempt except for payments of interest under s 20 of that Act [s CW 34(1)(g)].</td>
</tr>
<tr>
<td>New Zealand Maori Arts and Crafts Institute scholarships</td>
<td>Allowances paid under a scholarship by the Institute to students enrolled in the “Te Wananga Whakairo Rakau O Aotearoa” or a Diploma in Traditional Whakairo course are exempt from tax [see BR Prd 03/19 TIB vol 16:1 (February 2004) at 10, s CW 36].</td>
</tr>
<tr>
<td>Niue income derived by New Zealand company</td>
<td>Exempt [s CW 59].</td>
</tr>
<tr>
<td>Non-resident crew members</td>
<td>Amounts derived by a crew member of a pleasure craft are exempt where the amount is derived from services performed in New Zealand for a non-resident in relation to a pleasure craft while the craft is in New Zealand [s CW 21]. The following criteria apply: (a) the crew member must be not resident in New Zealand by virtue of the permanent place of abode test, must not be present in New Zealand on more than 365 days in any 24-month period commencing on or after 28 May 2002 and must not be unlawfully present in NZ; and (b) the pleasure craft must be a temporary import under s 116 Customs and Excise Act 1996 and must not be owned or partly-owned by a person who is a New Zealand resident or who is a controlled foreign company. For the purposes of the provision, the...</td>
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**Type** | **Details**
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Non-resident entertainers and visiting sportspeople | Income exempt only when derived from any activity or performance: (a) Pursuant to a cultural programme sponsored by any overseas government or the New Zealand Government; or (b) Pursuant to a programme of a foundation, trust, or other organisation which exists for the promotion of any cultural activity and not carried on for private pecuniary profit of any proprietor, member, or shareholder; or (c) For any game or sport where the participants are the official representatives of an association, league, union, or other body administering the game or sport in an overseas country. Only the official representatives of the body administering the game or sport in the overseas country are exempt. For example, a professional sporting team from one of the Australian states, not representing the Australian union or a body administering the game or sport for Australia as a whole, does not qualify for the exemption. The exemption does not apply to New Zealand based promoters of these activities [s CW 20].

Non-residents income | From personal services if stay does not exceed 92 days [see 1000 NON-RESIDENTS AND ABSENTEES, s CW 19].

Non-resident students, experts, and trainees | Income derived by non-resident students, experts, and trainees who are in New Zealand under arrangements for assistance entered into by the New Zealand Government. For example, students, experts, and trainees under the Colombo Plan, various programmes of SEATO, the Japanese Cultural and Technical Assistance Fund, and programmes of the United Nations or of specialised agencies of the United Nations, and to officers of the Western Samoan Public Service or the Cook Islands Public Service and residents of Western Samoa, the Tokelau Islands, or the Cook Islands (including Niue) who are in New Zealand for education, training, or experience. Residency is determined as if the 183-days residency rule did not exist [s CW 22].

Overseas social security payments | Overseas social security payments that are subject to the direct deduction policy are exempt. This does not include veterans’ pensions paid under the Social Welfare (Transitional Provisions) Act 1990 [s CW 28].

Personal service rehabilitation payments | [s CW 35, see 20 ACCIDENT COMPENSATION].

Petroleum exploration and development | Income derived by a non-resident company from drilling exploratory or development wells or undertaking seismic surveys relating to petroleum exploration in an offshore permit area. The exemption applies from the beginning of the 2005-2006 income year and ends on 31 December 2009. The Minister of Revenue has announced that this exemption is to be extended to 31 December 2014 [s CW 57, see 980.20].

Promotion bodies | Income derived by any society or association which is established mainly to advertise, beautify, or develop any city or district so as to attract trade, tourists, visitors, or population, or to create, increase, expand, or develop amenities for the general public, is exempt; provided no part of the income or other funds is used or available for non-charitable purposes. The exemption does not apply to council-controlled organisations or income...
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<tr>
<td>Exempt and Excluded Income</td>
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<tr>
<td><strong>Type</strong></td>
<td><strong>Details</strong></td>
</tr>
<tr>
<td>Providers of health, accident or life insurance or other welfare benefits</td>
<td>derived by local authorities from a council-controlled organisation [s CW 40].</td>
</tr>
<tr>
<td>Public authorities</td>
<td>The income (other than income received in trust) of any public authority is exempt [s CW 38]. However, income of the following entities is not exempt: (a) The Public Trustee; (b) The Ministry of Agriculture and Fisheries for any functions exercised by it under the Marketing Act 1936; (c) State enterprises; (d) Any public authority to the extent that it is a superannuation scheme; (e) Any Crown Research Institute.</td>
</tr>
<tr>
<td>Public or local authority sinking funds</td>
<td>Income derived by sinking funds for the public debt or local authority debt is exempt [s CW 38]. This does not include the debt of airport operators, energy trading operators, and harbour boards [s CW 39].</td>
</tr>
<tr>
<td>Racing industry</td>
<td>The income derived is exempt in certain circumstances [see 1180 RACING AND TROTTLING, s CW 47].</td>
</tr>
<tr>
<td>Racing stakes</td>
<td>Exempt [see 1180 RACING AND TROTTLING, s CW 47].</td>
</tr>
<tr>
<td>Reimbursement of employee expenditure</td>
<td>Reimbursement of expenditure incurred by an employee for which the employee would be allowed a deduction were it not for the employment limitation is exempt income of the employee [s CW 17, see 330.20].</td>
</tr>
<tr>
<td>Reimbursement of expenditure of volunteers</td>
<td>Reimbursement of expenditure incurred by a volunteer to cover actual expenses incurred by the volunteer is exempt income of the volunteer [s CW 62B, see 150.60].</td>
</tr>
<tr>
<td>Religious orders, board and keep of members</td>
<td>The value of personal board and lodging and other basic personal necessities received by a person whose sole occupation is in the service of a religious society where the conditions of service are such that no monetary remuneration or other rewards (other than those necessities) are payable for those services is exempt. In some cases the religious organisation itself provides the basic personal necessities, while in others the member is provided with money to buy the items personally. Whichever method is adopted, the value of the basic personal necessities is exempt from tax. [s CW 25].</td>
</tr>
<tr>
<td>Reserve Bank of New Zealand</td>
<td>The income derived is exempt. [s CW 38].</td>
</tr>
<tr>
<td>Scholarship or bursary</td>
<td>Any maintenance or allowance with respect to attendance at an educational institution under a scholarship or bursary is exempt. The exemption does not apply to a basic grant or an independent circumstances grant under regulations made under s 303 Education Act 1989 [see 710.90, s CW 36].</td>
</tr>
<tr>
<td>Scientific or industrial research associations</td>
<td>The income derived is exempt in certain circumstances [see 1240 RESEARCH AND DEVELOPMENT, s CW 49].</td>
</tr>
<tr>
<td>Sports bodies</td>
<td>The income derived is exempt in certain circumstances [see 225 COOPERATIVES, STATUTORY PRODUCER BOARDS, MUTUAL ASSOCIATIONS, CLUBS, AND SOCIETIES]. The exemption extends to non-residents, provided all other requirements of s CW 46 are met [see TIB vol 10:9 (September 1998) at 7-9].</td>
</tr>
</tbody>
</table>
### Exempt and Excluded Income

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<tbody>
<tr>
<td>Superannuation: portable NZ superannuation or veteran’s pension</td>
<td>Amounts received are exempt [s CW 28(1)(c), (1)(d)].</td>
</tr>
<tr>
<td>Tertiary education institutions</td>
<td>Income derived by a tertiary education institution which is established under Part 14 of the Education Act 1989 and which is not carried on for the private pecuniary profit of any individual [s CW 55BA].</td>
</tr>
<tr>
<td>Thalidomide victims trust</td>
<td>Income derived in trust for thalidomide victims is exempt. The trust may be created by an order of the Court under the Minors’ Contracts Act 1969 and also under the law of any country outside New Zealand [s CW 33(1)(e)].</td>
</tr>
<tr>
<td>Veterinary services</td>
<td>Income of the Veterinary Services Council, veterinary clubs, societies, or associations if established substantially or primarily for promoting efficient veterinary services in New Zealand, is exempt, provided no part of the income or other funds is used or available for private pecuniary profit of any proprietor, member, or shareholder or any associated person [s CW 50].</td>
</tr>
<tr>
<td>War pensions</td>
<td>Certain war pensions are exempt [s CW 28].</td>
</tr>
<tr>
<td>Welfare benefits</td>
<td>Monetary benefits granted under Part 1 of the Social Security Act 1964, other than any income tested benefit or New Zealand superannuation are exempt [s CW 33(1)(a)].</td>
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</table>

#### 370.20 Exemptions under other legislation [s CW 50]

Types of income and entities that are expressly exempted from income tax by legislation other than the ITA 2007 include:

(a) Diplomatic representatives of a foreign State, etc [see the Diplomatic Privileges and Immunities Act 1968];

(b) Arts Council of New Zealand;

(c) Broadcasting Commission;

(d) Broadcasting Standards Authority;

(e) Carter Observatory;

(f) Historic Places Trust;

(g) Income from free-of-tax Government stock issued in place of Bank of New Zealand shares;

(h) Money paid by any racing club, hunt club, or trotting club to the New Zealand Racing Conference or New Zealand Trotting Conference or by either of those Conferences to any club [Gaming Amendment Act 1953, s 8(7)];

(i) Payments made by the Asian Development Bank for services rendered to it are exempt from tax; and

(j) Certain payments made in consideration of the entering into of a conservation covenant over specified Maori land are exempted under the Forests Amendment Act 2004. That Act also provides for the Governor-General to exempt particular payments by way of order in Council.

#### 370.25 Excluded income

The following amounts are excluded income under the ITA 2007.

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<tr>
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<tr>
<td>Emissions units</td>
<td>Pre-1990 forest land emissions units disposed of (but not surrendered) where the underlying pre-1990 forest land is not held on revenue account. Fishing quota</td>
</tr>
<tr>
<td>Type</td>
<td>Details</td>
</tr>
<tr>
<td>------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Exempt and Excluded Income</td>
<td></td>
</tr>
<tr>
<td>Emissions units disposed of (but not surrendered) where the underlying quota is not held on revenue account</td>
<td>[s CX 51C]</td>
</tr>
<tr>
<td>Environmental restoration accounts</td>
<td>Refunds from environmental restoration accounts [s CX 52]</td>
</tr>
<tr>
<td>Fringe benefits</td>
<td>Fringe benefits are excluded income of the employee [s CX 3]</td>
</tr>
<tr>
<td>Government grants to business</td>
<td>Grants, subsidies and grant-related suspensory loans made by a local authority or public authority for a business carried on by the recipient. This provision does not cover a large budget screen production grant. Neither does it cover a grant made under the Agriculture Recovery Programme for the lower North Island and Eastern Bay of Plenty, to the extent to which the grant relates to expenditure which was incurred by the recipient before the grant was made and for which the recipient would be allowed a deduction under general tax law [s CX 47]</td>
</tr>
<tr>
<td>GST</td>
<td>Output tax received by a registered person and payable to the CIR [s CX 1]</td>
</tr>
<tr>
<td>Income equalisation schemes</td>
<td>Refunds of excess deposits made into a farming, fishing or forestry income equalisation scheme [s CX 51]</td>
</tr>
<tr>
<td>Inflation indexed instruments</td>
<td>An amount payable to the lender to the extent to which it represents a recovery of a decrease previously debited to the person’s account [CX 53]</td>
</tr>
<tr>
<td>Insurance underwriters</td>
<td>New Zealand resident unincorporated insurance underwriters — income derived from carrying on business outside New Zealand not referred to in certain paras of s YD 4 [s CX 41]</td>
</tr>
<tr>
<td>KiwiSaver and complying superannuation funds</td>
<td>Tax credits for KiwiSaver and complying superannuation funds [s CX 50]</td>
</tr>
<tr>
<td>Mineral mining</td>
<td>Profit on the disposal of mining shares is excluded income under certain circumstances [ss CX 44, CX 45]. Repayment of loans made from reinvestment profit [s CX 46]</td>
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<tr>
<td>New start grants</td>
<td>Amounts remitted as a condition of a new start grant [s CX 48]</td>
</tr>
<tr>
<td>Petroleum mining</td>
<td>Consideration derived from the disposal of shares or trust interests in a controlled petroleum mining entity [s CX 42]. Farm-in expenditure under a farm-out arrangement [s CX 43]</td>
</tr>
<tr>
<td>Portfolio investment entities</td>
<td>Proceeds from the disposal of shares (other than non-participating redeemable shares) issued by New Zealand and certain Australian companies [s CX 55]</td>
</tr>
<tr>
<td>Portfolio investment entities (PIEs)</td>
<td>Portfolio investor allocatee income and distributions of income by PIEs [ss CX 56B, CX 56C]</td>
</tr>
<tr>
<td>Portfolio investment entities (PIEs)</td>
<td>Credits for certain administration and management fees allocated to an investor where the fee is included in the PIE’s tax calculation [s CX 57]</td>
</tr>
<tr>
<td>Retirement savings scheme contributions</td>
<td>Contributions to a retirement savings scheme are excluded income of both the person for whose benefit the contributions is made and the retirement savings scheme. Some conditions apply [see 1390.98, s CX 50B]</td>
</tr>
<tr>
<td>Share-lending collateral derived by a person under a share lending arrangement.</td>
<td>Share-lending collateral is an amount paid to a share lender by a share user as security for the return of the original share or an identical share. The amount must be related to the market value of the share [s CX 54, see 1340.90]</td>
</tr>
</tbody>
</table>
### Exempt and Excluded Income

#### 370.30 International venture capital exemption [ss CW 12, CW 13]

Non-resident investors are exempt from income tax on profits derived from the sale of shares in unlisted New Zealand resident companies that do not engage in certain prohibited activities. Non-resident investors that qualify for the exemption are referred to as qualifying foreign equity investors (QFEIs). The objective of the exemption is to encourage foreign equity investment in new business ventures in New Zealand. The main requirements are that the non-resident investor must be resident in an approved territory, and it must be exempt from income tax in its country of residence. The exemption does not apply if the New Zealand company is engaged in certain excluded activities.

1. **Exemption requirements**
   - All of the following criteria must be met in order for the exemption to apply:
     1. a) The New Zealand company must be resident in New Zealand;
     2. b) The share, option, or convertible note, must have been held for not less than 12 months prior to its disposal;
     3. c) At some time during the 12-month period following purchase, the New Zealand company has been an unlisted company; and
     4. d) The non-resident investor remains a QFEI from the time of purchase to the time of disposal.

2. **Non-resident investor**
   - In order to be a QFEI, the non-resident investor must be resident in a country with which New Zealand has a double tax agreement (DTA), excluding Switzerland, and must be unable to benefit from a tax credit in their own country for any tax that would otherwise have been imposed in New Zealand. The exemption also applies where the investment is made through a “flow-through” limited partnership or other entity. Switzerland is not an approved territory because the DTA with that territory does not provide for the free exchange of tax information. For a list of approved territories (ie active DTAs) [see 310.40].
   - If the investment is made through an exempt partnership, all of the following criteria must be met:
     1. a) The partnership must be established under the laws of a country with which New Zealand has a DTA (excluding Switzerland);
     2. b) The partnership must have at least one general partner and one special partner;
     3. c) The general partner and all partners with a greater than 10 per cent interest in the partnership must be resident in a country with which New Zealand has a DTA (excluding Switzerland); and
     4. d) All partners with a greater than 10 per cent interest in the partnership must be unable to benefit from a tax credit in their own country for New Zealand tax that would otherwise be imposed.
   - If the investment is made through an exempt entity (other than an exempt partnership), the entity must be established under the laws of a country with which New Zealand has a DTA (excluding Switzerland) and all members with a greater than 10 per cent interest in the entity must be resident in a country with which New Zealand has a DTA (excluding Switzerland) and be unable to benefit from a tax credit for any New Zealand tax which would otherwise be imposed.

3. **Prohibited activities**
   - The New Zealand company must not have as a main activity, any one or more of the following:
     1. a) Land development;
     2. b) Land ownership;

---

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<td>Superannuation</td>
<td>Employer superannuation contributions are excluded income of both the employee contributions and the trustees of the superannuation scheme [s CX 49].</td>
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<td>Superannuation funds</td>
<td>Amounts derived from a life insurance policy [s CX 40].</td>
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(c) Mining;
(d) Provision of financial services;
(e) Insurance;
(f) Construction of public infrastructure;
(g) Acquisition of public infrastructure assets; or
(h) Investing with the main aim of deriving interest, dividends, rent or personal lease payments that are not royalties.

In order to accommodate investment into holding companies (including multiple tiers of holding companies), the exemption will still apply, provided that the New Zealand company has a main activity of providing capital to other companies, in the form of debt or equity funding, and the lower-tier company does not have as a main activity one or more of the prohibited activities.

4) New Zealand Venture Investment Fund

From 3 April 2006, the scheme is extended by the introduction of s CW 13. This section provides that the income derived by a non-resident investor from the sale or other disposal of a share or purchase option is exempt where the investment is made by the non-resident alongside New Zealand Venture Investment Fund Ltd (NZVIF). NZVIF is a Crown-owned company established to promote the development of the New Zealand venture capital industry. All of the following conditions must be met in order for the exemption to apply:

(a) The venture capital manager must have an agreement with NZVIF or a company owned by NZVIF;
(b) The agreement must require the venture capital manager to purchase a share or option on behalf of NZVIF or a company owned by NZVIF and an identical share or option on behalf of the non-resident;
(c) The agreement must specify that, at the time at which the investment is made, the company in which the investment is made has more than 50 per cent of the value of its assets and 50 per cent of its employees in New Zealand;
(d) The company invested into must not have as its main activity one of the activities listed in (a) to (h) above; and
(e) At the time of disposal of the share by the non-resident, both the venture capital manager and the non-resident must have complied with the obligations set out above and there must be no New Zealand resident investors who (with their associates) have a direct or indirect interest of more than 10 per cent in the share or option.

Normal dividend rules apply to dividends derived by the non-resident from the investee company.

370.35 Transitional Resident Exemption

An individual who falls within the definition of “transitional resident” is exempt from New Zealand tax on certain foreign-sourced income for the first 48 months following that person becoming tax-resident in New Zealand. The exemption applies to persons who became a transitional resident on or after 1 April 2006 and is effective for the 2005-2006 and later income years.

A “transitional resident” is an individual who:

(a) Is resident in New Zealand either under the 183-day test or because they have acquired a permanent place of abode in New Zealand [see 1250.35];
(b) Has not been tax-resident for a continuous period of at least 10 years, immediately before acquiring a permanent place of abode in New Zealand [see 1250.30, 1250.35];
(c) Has not previously been a transitional resident; and
(d) Has not ceased to be a transitional resident [s HR 8(2)].
The exemption begins on the first day when the person becomes resident in New Zealand and ends on the earlier of the day before the person ceases to be tax-resident, or on the last day of the 48th month following the month in which the person first became resident in New Zealand [s HR 8(3)-(6)].

Transitional resident status is optional. A person who does not wish to use the transitional resident exemption may elect not to be a transitional resident from a date of their choosing. Once made, the election is irrevocable. Any election must be made before the due date for the filing of the income tax return for the income year during which the person wishes the election to take effect. Extensions of time for the filing of an election are governed by s 37 of the TAA [see 1270.61].

The exemption applies to all foreign-sourced income other than income from employment services performed while the person is a transitional resident and income from the supply of services [ss HR 8, CW 27].

The effects of the transitional resident rules are:

(a) Foreign interest, dividends, royalties, rental income are exempt from New Zealand tax for the duration of the exemption. Income from employment performed while offshore (eg bonus payments derived before coming to New Zealand but received after arrival), gains from the disposal of revenue account property and offshore business income not related to the provision of services are likewise exempt [CW 27];

(b) Neither attributed CFC income nor CFC losses arise [ss CD 45, CQ 2, DN 2, EX 41];

(c) Foreign financial arrangements are not subject to the financial arrangement rules. To qualify for the exemption, no other party to the arrangement may be a New Zealand resident and the arrangement must not be for the purposes of a business carried on in New Zealand [s EW 17, EW 37, EW 41];

(d) Foreign Investment Fund income and losses do not arise [ss CQ 5, DN 6, EX 41, EX 64];

(e) Disclosure requirements for CFC and FIF interests do not apply while the person is a transitional resident;

(f) Income arising from the exercise of an employee share option is not subject to tax to the extent to which the gain relates to overseas employment. A pro-rata apportionment (on a time basis) is required where the employment to which the share option relates was performed both in New Zealand and offshore [s CD 2(9)];

(g) A trust is treated as a foreign trust. Therefore, the 12-month period in which to elect that the trust become a qualifying trust runs from the date on which the settlor ceases to be a transitional resident. During this period, the trustee is not subject to New Zealand tax on foreign income of the trust [ss HC 25, HC 30];

(h) Neither non-resident withholding tax nor approved issuer levy is required to be withheld from interest payments made to offshore lenders, provided that:
   (i) the money was borrowed while the person was a non-resident;
   (ii) the lender was not a person associated with the transitional resident; and
   (iii) the interest is not paid in relation to a business carried on through a fixed establishment in New Zealand [s RF 12(4)];

(i) Transitional residents and their spouses are subject to special rules in respect of any form of working for families tax credit [ss MC 5, MC 10, MD 7, see 420 FAMILY ASSISTANCE];

(j) No deductions are available against the exempt income [s DA 1].

The transitional resident exemption does not apply to any income that has a New Zealand source. For examples see TES 43 (November 2006) 665.

370.40 Canterbury earthquake relief [s CZ 23]

The Taxation (Canterbury Earthquake Measures) Act 2011 provides an exemption for certain welfare contributions made by an employer to employees as a result of the Christchurch earthquakes of 4 September 2010 and 22 February 2011.
There are three categories of exemption:

(a) Accommodation;

(b) Sundry fringe benefits where the employer cannot reasonably estimate which employees received which benefits [s CZ 24, see 540.257]; and

(c) The first $3,200 per earthquake of monetary remuneration and fringe benefits of the kind where the employer can reasonably be expected to know which employees received which benefits.

The s CZ 23 income tax exemption applies where all of the following criteria are met:

(a) The benefit was provided for the purpose of relieving employees of the effects of the earthquakes;

(b) The benefit would otherwise have been taxable income;

(c) The benefit was derived in the eight weeks following the relevant earthquake;

(d) The benefit was not paid as a substitute for salary or wages;

(e) The amount of the benefit is not dependent on the seniority of the employee;

(f) If the employee who received the benefit is associated with the employer, the benefit is also available to non-associated full-time employees; and

(g) The employer elects to treat the income as exempt income of the employee.

Provided the criteria are met, all accommodation benefits as defined in s CE 1(2) are exempt. The definition includes board or lodging, or the use of the whole or part of a house or living premises. In relation to each of the two earthquakes, the first $3,200 paid to each employee (other than accommodation benefits) is also exempt.
## Chapter 420
### Family Assistance

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### Working for families tax credits

Under the working for families (WFF) tax credits scheme, the parents or caregivers of children (18 years or under) may be eligible to receive one or more of the following tax credits, depending on the number of dependent children, total family income, and whether or not an income-tested benefit is being received:

(a) **Family tax credit**: a credit of tax is paid for each dependent child, the amount (ranging from $3,182 to $5,303) depending on the age of the child [see 420.25].

(b) **In-work tax credit**: a payment of $3,120 per year ($60 per week) for up to three children, plus $780 per year ($15 per week) for each child in excess of three children, is made to working parents or caregivers with dependent children. The credit is not paid to parents or caregivers who receive certain forms of government assistance such as income-tested benefits [see 420.30].

(c) **Child tax credit**: a credit of tax of $780 per child per year is paid to parents or caregivers who do not receive other forms of government assistance such as income-tested benefits. This credit is being phased out and replaced by the in-work payment [see 420.35].

(d) **Parental tax credit**: a one-off credit of tax of $1,200 is paid for each dependent child born on or after 1 October 1999 to caregivers who are not in receipt of other forms of government assistance such as income-tested benefits [see 420.40].

(e) **Minimum family tax credit**: a credit of tax is paid to the parents or caregivers of dependent children sufficient to ensure that gross annual family income is at least $22,204 [see 420.50]. The credit is not paid to parents or caregivers who receive certain forms of government assistance such as income-tested benefits.

The amount received from the family tax credit, the in-work tax credit (or the child tax credit) and the parental tax credit is reduced by the credit abatement [see 420.45], if total family income exceeds $36,827 a year.

The amounts shown above are for the 2011-2012 income year.
WFF tax credits are calculated by the CIR [s MD 2(1)]. Family scheme tax credits are excluded income [s MA 3].

**Note:** For the purposes of the family scheme rules, a spouse includes a person with whom another person has entered into a de facto relationship or civil union. The term “married” is used in Staples Tax Guide to include persons who are in a de facto relationship or civil union; “unmarried” has a corresponding meaning [see 960.10].

**420.10 Principal caregiver** [s MC 10]
A “principal caregiver” for a dependent child means the person (whether or not a parent) who the CIR considers has the primary responsibility for the day-to-day care of the child other than on a temporary basis. The following cannot be principal caregivers:

(a) A body of persons, (whether incorporated or not);

(b) The proprietor or an employee of:

(i) A residence established under the Children, Young Persons, and Their Families Act 1989;

(ii) Any residential disability care institution (within the meaning of s 58(4) Health and Disability Services (Safety) Act 2001); or

(iii) Any other institution in which the child is being cared for;

(c) A person who is eligible to be a transitional resident, who has not elected under s HR 8(4) not to be a transitional resident, or their spouse.

The meaning of “principal caregiver” is modified for different tax credits. The modified meaning is explained in the relevant paragraph. The principal caregiver is required to notify Inland Revenue of any change in the arrangements for the care of the child that will affect the person’s status as a principal caregiver.

“Family scheme income” is net income modified for the purposes of the family scheme [see 420.60].

**420.15 Qualifying person** [ss MC 2, MC 3, MC 4, MC 5, MC 6, MC 7, MC 8, MC 9]
A person qualifies for an entitlement under the family scheme if, for an entitlement period, they meet the following criteria:

(a) The person is 16 years of age or older [s MC 3];

(b) The person is the principal caregiver for one or more dependent children [s MC 4, see 420.10];

(c) Either the person or the dependent child meets the residence requirement:

(i) The person meets the residence requirements if they are a New Zealand resident who has been both resident and present in New Zealand for a continuous period of 12 months at any time, and are tax resident and present in New Zealand on the date the tax credit arises. In addition, the person must not be a transitional resident, not have made an election not to be a transitional resident, and not be the spouse of a transitional resident [s MC 5(2)];

(ii) The dependent child meets the residence requirements if the dependent child is both resident and present in New Zealand for the entitlement period [s MC 5(3)].

A person does not qualify for an abating working for families (WFF) tax credit if, during the relationship period, they receive a parent’s allowance under s 32(2) of the War Pensions Act 1954 [s MC 6(a)]. A person does not qualify for an in-work payment, parental tax credit or minimum family tax credit if, during the relationship period, they receive an income-tested benefit or a parent’s allowance [s MC 6(b)].

If a person and their spouse both meet the qualifying criteria and both have dependent children, only one of those persons can be the qualifying person in respect of all of those children. The CIR decides who that person is [s MC 7].

An “entitlement period” means a period (forming all or part of a relationship period) during which a person meets the continuing requirements set out below [s MC 11].
A “relationship period” means an unbroken period in a tax year. It may consist of some or all of the days in the tax year [s MC 11].

In order to receive entitlements and tax credits under the family scheme, a person who meets the qualifying criteria in ss MC 3 to MC 7 must also meet the following requirements throughout the entitlement period:

(a) The person meets the qualifying criteria on each day of the period;
(b) Another person does not start or stop being the person’s spouse;
(c) The person does not start or stop being the principal caregiver of a dependent child (other than on the first or last day);
(d) A child for whom the person is the principal caregiver does not stop being a dependent child (other than on the first or last day);
(e) The composition of a tax credit does not change (other than on the first or last day); and
(f) The person does not start or stop being a person receiving a protected family tax credit (other than on the first or last day) [s MC 8].

If a child is treated as financially dependent under the in-work tax credit rules [s MD 6(2)], the above requirements do not have to be met [s MC 8(2)].

For example, if a child is born during a tax year, there will be two entitlement periods — one up to the date of birth, and one from the date of birth to the following 31 March.

A “protected family tax credit” is an amount of family scheme income derived in the manner set out in s MD 14 [s YA 1, see 420.45].

The abating WFF tax credit and a minimum family tax credit are payable for a child aged 18 if the child is not financially independent and is attending school or a tertiary educational establishment [s MC 9].

420.20 Abating WFF tax credit [ss MD 1, MD 2]

A person who qualifies for an entitlement under the family scheme [see 420.15] is entitled to receive the “abating WFF tax credit”, which is calculated as follows:

\[
\text{family tax credit} + \text{(in-work tax credit or child tax credit)} + \text{parental tax credit} - \text{credit abatement}
\]

Where:
“Family tax credit” as explained in 420.25;
“In-work tax credit” as explained in 420.30;
“Child tax credit” as explained in 420.35;
“Parental tax credit” as explained in 420.40; and
“Family credit abatement” as explained in 420.45;

In calculating the individual credits making up the abating WFF tax credit, the CIR must:

(a) Treat the family tax credit, in-work tax credit, child tax credit, and the parental tax as tax credits corresponding to the period;
(b) Treat the family credit abatement as a debit to the period; and
(c) Apply the amount of the family credit abatement first to reduce the family tax credit, secondly to reduce the in-work tax credit or child tax credit, and thirdly to reduce the parental tax credit [s MD 2].

420.25 Family tax credit [s MD 3]

The family tax credit is payable to the principal caregiver [see 420.10], of one or more children, and is calculated using the following formula:

\[
\text{prescribed amount} \times \frac{\text{days}}{365}
\]

Where:
“Prescribed amount” is the sum of the following amounts:
Family Assistance

(a) For the eldest dependent child:
   (i) $4,578 if aged under 16; or
   (ii) $5,303 if aged 16 or more. If the eldest dependent child turns 16 during the entitlement period, the weighted average of $4,578 and $5,303 is used.

(b) For each additional dependent child:
   (i) $3,182 if aged under 13;
   (ii) $3,629 if aged 13, 14, or 15; or
   (iii) $4,745 if aged 16 or more. If a child turns 13 during the entitlement period, the weighted average of $3,182 and $3,629 is used. If a child turns 16 during the entitlement period, the weighted average of $3,629 and $4,745 is used.

The prescribed amounts shown above apply for the 2011-2012 income year.
The prescribed amounts for the 2012-2013 income year are $4,822 and $5,303 (for the eldest dependent child) and $3,351, $3,822 and $4,745 (for additional dependent children).

“Days” is the number of days in the entitlement period.
The family tax credit is reduced in proportion to the time in the entitlement period that a dependent child spends in the exclusive care of another qualifying person.

“Child” means an unmarried person who:

(a) Is aged 15 years or less;
(b) Is aged 16 or 17 years and is not financially independent; or
(c) Is aged 18 years and is a person for whom a credit of tax is allowed under s MD 1 or both ss MD 1 and ME 1 [s YA 1].

“Dependent child”, in relation to any person, means a child:

(a) Whose care is primarily the responsibility of that person;
(b) Who is maintained as a member of that person’s family;
(c) Who is financially dependent on that person;
(d) Who is not a child for whom payments are being made under s 363 of the Children, Young Persons, and Their Families Act 1989; and
(e) Who is not a child for whom an orphan’s benefit or an unsupported child’s benefit [ss 28 and 29 of the Social Security Act 1964] are being paid [s YA 1].

Despite paragraph (d), a child for whom payments are being made under s 363 of the CYPF Act 1989 is a dependent child if s 361 of the CYPF Act 1989 applies to the child, and the child is placed (under s 362 of the CYPF Act 1989) in the care of a person who is the child’s parent. This enables the parents of a child who has been returned to their care, but not their custody, to claim WFF tax credits.

420.30 In-work tax credit [ss MC 10(3), (4), MD 4, MD 5, MD 6, MD 7, MD 9, MD 10]

(1) Criteria for entitlement [ss MC 10(3), (4), MD 4–MD 9]

A principal caregiver is entitled to the in-work tax credit for a child if for an entitlement period, the person meets the following conditions:

(a) The principal caregiver is aged 16 years or over;
(b) The principal caregiver is primarily responsible for the care of the child;
(c) The child is financially dependent on the principal caregiver [requirements (b) and (c) override the continuing requirements set out in s MC 8 — see 420.15];
(d) The principal caregiver or the child satisfies the residence requirements (see below);
(e) Neither the principal caregiver nor their spouse receives an income-tested benefit, a basic grant, an independent circumstances grant, or a parent’s allowance under the War Pensions Act 1954; and

(f) The principal caregiver and/or their spouse satisfies the full-time earner requirement (see below).

For the purposes of the in-work tax credit, a principal caregiver includes a person (the first person) who lives apart from another person who qualifies for entitlements under the family scheme (eg in the case of separated parents), and the first person has the dependent child in their exclusive care for periods totalling at least one-third of a four-month period or the tax year. In this situation, the principal caregiver is entitled to receive the in-work tax credit for the periods the child is in their exclusive care.

(2) **Residence requirements [s MD 7]**

To qualify for the in-work tax credit, either the principal caregiver or the child must satisfy the residence requirement. A principal caregiver satisfies the residence requirement if the principal caregiver:

(a) Is both resident and present in New Zealand for a continuous period of 12 months at any time, and is resident and present in New Zealand on the date an abating WFF tax credit arises; and

(b) Is neither a transitional resident nor the spouse of a transitional resident [see 370.35].

A child satisfies the residence requirement if the child is both resident and present in New Zealand for the entitlement period.

(3) **Full-time earner requirement [s MD 9]**

To qualify for the in-work tax credit, either or both the principal caregiver and their spouse must be normally a full-time earner receiving income from a work activity, and must derive:

(a) Income as a full-time earner, as described below; or

(b) An amount of compensation (as described below).

A “full-time earner” is a person who:

(a) Is unmarried and employed for 20 hours or more a week; or

(b) Is married and together they are employed for 30 hours or more a week.

The full-time earner requirement is also met if a person is normally a full-time earner but in a one-week period they do not work, or work less than, the number of hours required to be a full-time earner because of the birth of a child. This applies only if the person is entitled to receive the parental tax credit for that child.

To satisfy the above requirement to derive income as a full-time earner, the income derived must be:

(a) A PAYE income payment [see 1090.10], but not an excluded PAYE income payment (see below) or a benefit or allowance described in s MD 8 (ie an income-tested benefit, a basic grant, an independent circumstances grant, or a parent’s allowance under the War Pensions Act 1954);

(b) Shareholder-employee salaries from close companies not received by way of regular payments during the year;

(c) Income from a business carried on for profit; or

(d) An amount paid or benefit provided by a person, who receives a personal service rehabilitation payment, to another person for a key aspect of social rehabilitation.

Excluded PAYE income payments are:

(a) Accident compensation earnings-related payments [as defined in s YA 1], other than payments of weekly compensation under the Injury Prevention, Rehabilitation, and Compensation Act 2001;

(b) Gratuitous payments, other than parental leave payments, made to a person in return for services that the person or their parent, child, spouse, former spouse or dependant provided to the payer, when the payment would not have been made if the services had not been provided;

(c) Veteran’s pensions, New Zealand superannuation and living alone payments;

(d) Schedular payments, being contract payments for contract activities or services of non-resident contractors;
(e) Compensation paid as a result of an incapacity (suffered before 1 January 2006), due to personal injury by accident as defined in s 26 of the Injury Prevention, Rehabilitation, and Compensation Act 2001.

To satisfy the above requirement to derive an amount of compensation, the person must meet all of the following conditions:

(a) They receive a child tax credit for an entitlement period ending on 31 March 2006;
(b) On or after 1 January 2006, they or their spouse suffers an incapacity due to personal injury by accident;
(c) Weekly compensation is or will be paid for the incapacity; and
(d) The requirement to derive income as a full-time earner would have been met and the person would have been eligible for the in-work tax credit if s MD 9 had been in force before the date of the incapacity.

(4) Calculation of in-work tax credit [s MD 10]

For each week in which the principal caregiver or their spouse is entitled to receive the in-work tax credit and is a full-time earner, the in-work tax credit is $60 if the principal caregiver is responsible for one, two or three children, plus $15 for each child in excess of three.

<table>
<thead>
<tr>
<th>Number of dependent children</th>
<th>Weekly in-work tax credit entitlement</th>
<th>Full-year in-work tax credit entitlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$60</td>
<td>$3,120</td>
</tr>
<tr>
<td>2</td>
<td>$60</td>
<td>$3,120</td>
</tr>
<tr>
<td>3</td>
<td>$60</td>
<td>$3,120</td>
</tr>
<tr>
<td>4</td>
<td>$75</td>
<td>$3,900</td>
</tr>
<tr>
<td>5</td>
<td>$90</td>
<td>$4,680</td>
</tr>
<tr>
<td>6</td>
<td>$105</td>
<td>$5,460</td>
</tr>
</tbody>
</table>

Depending on the family’s net income, the in-work tax credit may be reduced by the credit abatement [see 420.45].

420.35 Child tax credit [ss MZ 1, MZ 2]

The child tax credit is only available to persons who meet the following criteria:

(a) The person was eligible for a child tax credit as at 31 March 2006;
(b) The person is not entitled to an in-work tax credit; and
(c) The person continues to be entitled to a child tax credit at all times after 31 March 2006 (ie there is no break in the entitlement).

The child tax credit is calculated using the following formula:

\[
\frac{($780 \times \text{dependent children} \times \text{days in entitlement period})}{365}
\]

Where:

“Dependent children” is the number of dependent children for whom the person is a principal caregiver during the entitlement period; and

“Days in entitlement period” is the number of days in the entitlement period for which the person and their spouse, do not receive a social assistance payment and do not have a suspended entitlement to an income-tested benefit.

“Social assistance payment” means:

(a) An income-tested benefit;
(b) A veteran’s pension;
(c) New Zealand superannuation;
(d) A basic grant or an independent circumstances grant; or
(e) An accident compensation earnings-related payment [s MA 8].

420.40 Parental tax credit [ss MC 10(5), MD 11, MD 12]
The parental tax credit entitles a qualifying person (usually the mother) to $1,200 for each child born, provided the parents have not (during the parental entitlement period) received a social assistance payment [see 420.35], or a suspended entitlement to an income-tested benefit. If the parents have received a parental leave payment at any time for the child, they do not qualify for the parental tax credit. A qualifying person continues to be entitled to the credit even if the child dies within eight weeks of birth.

The parental tax credit for a parental entitlement period is calculated using the following formula:

\[
\text{prescribed amount} \times \frac{\text{days}}{56}
\]

Where:

“Prescribed amount” is $1,200; and
“Days” is the number of days in the parental entitlement period (up to a maximum of 56) for which the person and their spouse, do not receive a social assistance payment and do not have a suspended entitlement to an income-tested benefit.

The “parental entitlement period” is the first 56 days after the date of the dependent child’s birth.

For the purposes of the parental tax credit, a principal caregiver includes a person (the first person) who lives apart from another person who qualifies for entitlements under the family scheme (eg in the case of separated parents), and the first person has the dependent child in their exclusive care for periods totalling at least one-third of the parental entitlement period.

The parental tax credit is paid to the qualifying person either as a tax credit in an end-of-year assessment, or by instalment. If an application is made, the credit is paid by instalment in the 56 days following the date of application [see 420.70]. To receive the credit by interim instalment, application must be made within three months of the child’s birth.

420.45 Credit abatement [ss MD 1(3), MD 13, MD 14, MD 15, MD 16]
The credit abatement is the total, for an entitlement period, of:

(a) The family credit abatement; and
(b) The parental tax credit abatement [s MD 1(3)].

(1) Family credit abatement [ss MD 13, MD 14, MD 15]
The family credit abatement for an entitlement period is calculated using the following formula:

\[
\frac{\text{full-year abatement} \times \text{days}}{365}
\]

Where:

“Full-year abatement” is 20 cents for each whole dollar of family scheme income (if any) including that of a spouse in excess of $36,827;
“Days” is the number of days in the entitlement period (excluding the days of any calendar months in which the person receives protected family tax credit).

A person receives protected family tax credit for a calendar month in an entitlement period if the person:

(a) Has no spouse, receives an income-tested benefit and derives family scheme income that is less than $36,827; or
(b) Has a spouse, receives an income-tested benefit and derives family scheme income that (together with the family scheme income of their spouse) is less than $36,827.

In calculating family scheme income:

(a) Section MB 1(1)(a) and (b) do not apply; and
420.45(2) Family Assistance

(b) Employment income derived in the calendar month from an extra pay period is ignored; and
(c) Any business income and shareholder-employee income from a close company that is not subject to PAYE, and any expenditure incurred in deriving that assessable income, are treated as derived and incurred at a uniform daily rate over the income year (or part of the income year).

“Family scheme income” is defined in 420.60.

If the parental tax credit is received by fortnightly instalments, and the 56-day entitlement period includes 31 March, the family credit abatement is applied so that instalments received in the first tax year are abated against family scheme income for that tax year, and instalments received in the second tax year are abated against family scheme income for the second tax year.

(2) **Parental tax credit abatement [s MD 16]**

A person who is entitled to a parental tax credit is required to take the parental tax credit abatement into account when calculating their abating WFF tax credit if:

(a) They choose to have the parental tax credit paid in a lump sum; and
(b) The birth occurs within 56 days of the end of the tax year.

The parental tax credit abatement is calculated using the formula:

\[
\text{full-year abatement} \times \left( \frac{56}{365} \right) - \text{amount used}
\]

Where:

“Full-year abatement” is as explained above;

“Amount used” is the amount of family credit abatement as calculated above for an entitlement period that ends on 31 March, to the extent that the abatement would be applied under s MD 2(2)(c)(i) and (ii) in calculating a net contribution.

420.50 **Minimum family tax credit [ss ME 1, ME 2, ME 3]**

The minimum family tax credit is payable to any qualifying person whose net family scheme income for the tax year is less than $22,204 ($22,568 from 1 April 2012). The Governor-General may prescribe a higher amount by Order in Council. A qualifying person is a person who meets the requirements of ss MC 3 to MC 6 [see 420.15]. The tax credit is payable for an entitlement period.

(1) **Calculation of credit [s ME 1]**

The minimum family tax credit is calculated by the following formula:

\[
\text{(prescribed amount – net family scheme income)} \times \left( \text{weekly periods} / 52 \right)
\]

Where:

“Prescribed amount” is $22,204 ($22,568 from 1 April 2012);

“Net family scheme income” is the net family scheme income (see below) for a relationship period containing the entitlement period of the person and/or their spouse civil union partner, or de facto partner;

“Weekly periods” is the number of one-week periods in the entitlement period for which the person is a full-time earner.

A “full-time earner” [s MA 7] is a person who:

(a) Is unmarried and employed for 20 hours or more a week; or
(b) Is married and together they are employed for 30 hours or more a week.

A person does not lose their status as a full-time earner if they work fewer hours than normal as a result of incapacity due to personal injury or because the person is taking parental leave for which they receive a parental leave payment.
(2) **Meaning of employment [s ME 2]**

For the purposes of the minimum family tax credit, “employment” in the definition of “full-time earner” means the activity that gives rise to an entitlement to a PAYE income payment other than:

(a) A payment by a partnership to a working partner under s DC 4;
(b) An income-tested benefit;
(c) A veterans’ pension;
(d) New Zealand superannuation;
(e) A living-alone payment;
(f) A basic grant or an independent circumstances grant;
(g) A contract payment to a non-resident contractor;
(h) A payment made by a close company to a major shareholder;
(i) A payment made by a person to their spouse; or
(j) A payment made by a business carried on jointly or in partnership to a spouse of a partner.

(3) **Net family scheme income [s ME 3]**

Net family scheme income means the amount calculated using the following formula:

\[
\text{adjusted income} - \text{adjusted liability} + \text{amount received} - \text{amount paid}
\]

Where:

“Adjusted income” is the person’s net income under s MB 1 [see 420.60] for the tax year in which the relationship period falls that is attributable to the number of weeks in which the person is a full-time earner, adjusted to an annualised amount that is found by multiplying the amount by the fraction that is 52 divided by the number of weeks in the relationship period for which the person is a full-time earner. For this purpose, s MB 1(2) and (3) are ignored;

“Adjusted liability” is the amount of tax that would be payable by the person on adjusted income;

“Amount received” is the total of overseas pensions, child support and spousal maintenance (which are exempt income but are added back to net income for the purposes of calculating family scheme income) derived by the person for the tax year;

“Amount paid” is the total of child support and spousal maintenance (which are deducted from net income for the purposes of calculating family scheme income) paid by the person for the tax year.

**Example:**

Homer and Marge Simson are married and have a three-year-old child. Marge was a full-time earner for the whole of the tax year, earning wages of $12,875 and interest of $91. Homer worked part-time earning $1,242. He also received gross dividends of $1,548. Their net family scheme income is calculated as follows:

<table>
<thead>
<tr>
<th></th>
<th>Marge</th>
<th>Homer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment earnings</td>
<td>$12,875.00</td>
<td>$1,242.00</td>
</tr>
<tr>
<td>Interest</td>
<td>$91.00</td>
<td>nil</td>
</tr>
<tr>
<td>Dividends</td>
<td>nil</td>
<td>$1,548.00</td>
</tr>
<tr>
<td>Taxable income</td>
<td>$12,966.00</td>
<td>$2,790.00</td>
</tr>
<tr>
<td>Tax on taxable income (at 2011-2012 rates)</td>
<td>$1,361.43</td>
<td>$292.95</td>
</tr>
<tr>
<td>Net family scheme income</td>
<td>$11,604.57</td>
<td>$2,497.05</td>
</tr>
</tbody>
</table>

Their minimum family tax credit is $8,102.38 calculated as follows:

\[
(\text{gross income} - (\text{adjusted income} + \text{amount received} - \text{amount paid})) \times \frac{52}{52}
\]

Homer and Marge will also be entitled to the abating WFF tax credit.
An anti-abuse provision enables the CIR to determine the extent to which a person is a full-time earner if that person receives a PAYE income payment but does not perform duties to the extent that would justify entitlement to that PAYE income payment [s ME 2(2)-(4)].

**420.60 Determination of family scheme income** [ss MB 1 - MB 13,]

(1) **Assessable income derived at uniform daily rate** [s MB 1(1)]

The family scheme income on which the calculation of family scheme tax credits is based is the person’s net income as determined by applying certain rules and after making certain adjustments. The following general rules apply:

(a) Income from employment is treated as derived at a uniform daily rate during the period of employment;

(b) Income from income-tested benefits is treated as derived at a uniform daily rate during the period for which it is paid;

(c) Income from other sources is treated as derived at a uniform daily rate during the income year; and

(d) Any expenditure incurred in deriving the income in (c) is treated as incurred at a uniform daily rate during the income year.


(2) **Amounts added to net income**

The following amounts must be included in net income in determining family scheme income:

<table>
<thead>
<tr>
<th>Description of item</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overseas pensions which are exempt under s CW 28(1)(e). Such pensions cause a deduction to be made by Work and Income New Zealand against any monetary benefit other than New Zealand superannuation or a veteran’s pension.</td>
<td>MB 1(2)(a)</td>
</tr>
<tr>
<td>Child support, spousal maintenance or maintenance received and exempt under s CW 32.</td>
<td>MB 1(2)(a)</td>
</tr>
<tr>
<td>Income attributed by a portfolio investment entity to a person, if the portfolio investment entity is not a superannuation fund or a retirement savings scheme.</td>
<td>MB 1(5)(a)(ii)</td>
</tr>
<tr>
<td>A distribution from a listed PIE.</td>
<td>MB 1(5)(b)</td>
</tr>
<tr>
<td>For a person who is a major shareholder in a close company, the amount calculated under s MB 4(2) (see below for details).</td>
<td>MB 4</td>
</tr>
<tr>
<td>The amount of an employer’s contributions to a superannuation scheme for the tax year and the preceding two tax years, if the employee continues to work for the employer for more than one month after receiving a distribution from the superannuation scheme (see below for details).</td>
<td>MB 5</td>
</tr>
<tr>
<td>A distribution from a retirement savings scheme (see below for details).</td>
<td>MB 6</td>
</tr>
<tr>
<td>The family scheme income of a settlor of a trust includes the undistributed income of the trust, unless the settlor is merely providing personal services for less than market value (see below for details).</td>
<td>MB 7</td>
</tr>
<tr>
<td>The taxable value of fringe benefits a company must attribute to a person and the company’s FBT liability in relation to the person, if the person is an employee of, and has a controlling interest in, the company (see below for details).</td>
<td>MB 8</td>
</tr>
</tbody>
</table>
The amount deposited into a person’s main income equalisation account for an accounting year (see below for details).

Half of the amount of a pension or annuity derived in the income year if the pension or annuity is exempt income under s CW 4 or is a pension from a superannuation fund.

Amounts derived (in excess of $500) by a dependent child of the person (see below for details).

The non-residents’ foreign-sourced income of the person’s spouse, civil union partner or de facto partner.

The value of amounts paid or provided to a person from any source and used by the person to replace lost or diminished income of the person or the person’s family, or to meet usual living expenses of the person or the person’s family. Exclusions apply (see below for details).

### 3) Amounts excluded from net income

The following amounts must be excluded from net income in determining family scheme income:

<table>
<thead>
<tr>
<th>Description of item</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>An amount of tax loss of a qualifying company attributed to a person as a shareholder of that company.</td>
<td>MB 1(4)</td>
</tr>
<tr>
<td>Income attributed by a portfolio investment entity to a person, if the portfolio investment entity is a superannuation fund or a retirement savings scheme.</td>
<td>MB 1(5)(a)(i)</td>
</tr>
<tr>
<td>An amount of retirement scheme contribution that is not excluded income but would be excluded income if not for s CX 50B(2).</td>
<td>MB 1(5B)</td>
</tr>
<tr>
<td>An amount of depreciation loss allowed in the 2002-2003 or earlier income year in relation to a building, if the person derives assessable income from the sale of the building. This does not apply to an amount of depreciation loss of a business that under s MB 4 is treated as having no net income for the purposes of calculating family scheme income.</td>
<td>MB 1(5C)</td>
</tr>
<tr>
<td>A refund under ss EH 8 to EH 26 (which relate to refunds from main income equalisation accounts) of a deposit made on or after 1 April 2011, except to the extent that the refund is interest on the deposit payable to the person under s EH 6.</td>
<td>MB 1(5D)</td>
</tr>
<tr>
<td>A child tax credit under s MZ 2 [1395.55].</td>
<td>MB 1(7)</td>
</tr>
<tr>
<td>Income from business or investment activities that produce a net loss (see below for details).</td>
<td>MB 3</td>
</tr>
</tbody>
</table>

### 4) Amounts allowed as deductions

The following amounts may be claimed as deductions in determining family scheme income:

<table>
<thead>
<tr>
<th>Description of item</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>Child support, spousal maintenance or maintenance paid by the person and exempt to the recipient under s CW 32.</td>
<td>MB 1(3)(a)</td>
</tr>
<tr>
<td>Any payment made during the income year under s 27K of the Social Security Act 1964.</td>
<td>MB 1(3)(b)</td>
</tr>
</tbody>
</table>

### 5) Amounts not allowed as deductions

The following amounts cannot be claimed as deductions in determining family scheme income:

<table>
<thead>
<tr>
<th>Description of item</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deductions for business or investment activities that produce a net loss (see below for details).</td>
<td>MB 3</td>
</tr>
</tbody>
</table>
(6) **Adjustment for a period of more or less than a year** [s MB 2]
If a person’s income is calculated for a period of more or less than a year, their family scheme income must be adjusted using the formula:

\[
\text{family scheme income} \times \frac{365}{\text{days}}
\]

Where:

“Family scheme income” is the person’s income calculated under subparts MB to MF and MZ;

“Days” is the total days in the period for which the income has been derived.

(7) **Net losses from businesses or investment activities** [s MB 3]
The income and deductions for a business or investment activity carried on by a person are ignored when calculating the person’s family scheme income if the business or investment activity produces a net loss for the year. If the person carries on more than one business or investment activity, each business or activity must be considered separately.

Deductions that relate to an asset used in carrying on two or more business or investment activities must be appropriately apportioned between the activities on the basis of the use of the asset in those activities. If two or more business or investment activities are carried on, the CIR may treat them as a single activity if the CIR considers they are of a kind that are normally carried on together.

“Investment activity” includes passive holding of an investment asset, other than a variable principal debt instrument. This would include rental properties and trading in shares, for example.

(8) **Major shareholders in close companies** [s MB 4]
A person who is a major shareholder (ie owns or controls 10 per cent or more of the company’s ordinary shares or voting rights) in a close company on the company’s balance date is required to include in their family scheme income the amount calculated by the following formula:

\[
\left(\frac{\text{person’s shares}}{\text{company’s shares}}\right) \times \text{company’s income}
\]

Where:

“Person’s shares” is the number of shares (excluding fixed-rate shares) held by the person in the company on the last day of the accounting year;

“Company’s shares” is the total number of shares (excluding fixed-rate shares) issued by the company as at the last day of the accounting year;

“Company’s income” is the net income of the company for the accounting year.

If the company has paid the major shareholder a dividend in the income year, the amount of family scheme income calculated under the above formula is reduced by the total dividends paid for the income year.

(9) **Distributions from superannuation schemes** [s MB 5]
Where a person receives a distribution from a superannuation scheme, and an employer has made contributions to that superannuation scheme and the person continues to work for that employer more than one month after the date of the distribution, the amount of the employer’s contributions for that tax year and the preceding two tax years is included in the person’s income for the appropriate tax years, less an amount attributable to the member’s contributions for any year. This does not apply to a person who receives a distribution from a superannuation scheme as a result of, and on or after the person’s retirement from, employment with an employer who was a contributor to the scheme.

(10) **Distributions from retirement savings schemes** [s MB 6]
Where a person receives a distribution of a retirement scheme contribution from a retirement savings scheme, the distribution is treated as family scheme income derived by the person in the income year of distribution if RSCT has been withheld from the contribution and, at the time of the distribution, the person is not eligible to receive New Zealand superannuation but is eligible to receive a retirement scheme contribution from a retirement scheme contributor.
(11) **Settlor of trust [s MB 7]**

The family scheme income of a person who is the settlor of a trust during the income year includes the undistributed income of the trust, as calculated below. This does not apply if:

(a) The person is the settlor of a trust solely as a result of providing personal services, for less than market value, in the administration of the trust or the maintenance of the trust property;

(b) The trustee of the trust is registered as a charitable entity under the Charities Act 2005;

(c) The trust is solely for the benefit of a local authority;

(d) Interest and dividends derived by the trustee of the trust would be exempt income of the trustee under s CW 45 (funeral trusts);

(e) The trust is a superannuation fund; or

(f) The person and the members of the person’s family are not permitted to benefit from the trust except under a court order.

If s MB 7 applies, the person’s family scheme income includes the amount calculated under the formula:

\[
\text{trustee + company – dividends/settlor number}
\]

Where:

“Trustee” is the net income of the trustee of the trust for the income year reduced, to not less than zero, by the amount of the trustee’s income that vests or is paid by the trustee as beneficiary income for the income year;

“Company” is the total of amounts calculated for companies in which, at the end of the company’s income year, the trustee of the trust and associated persons hold voting interests of 50 per cent or more, or market value interests of 50 per cent or more if there is a market value circumstance, with the amount for each company being calculated by multiplying the company’s net income for the income year by the trustee’s voting interest or market value interest in the company at the end of the income year;

“Dividends” is the total amount, not exceeding the item “company”, of dividends that are derived by the trustee of the trust in the income year from companies as defined above;

“Settlor number” is the number of settlors of the trust, including the person, for which s MB 7 applies.

(12) **Fringe benefits [s MB 8]**

A person’s family scheme income for an income year includes:

(a) The taxable value of the fringe benefits that a company must attribute to the person under ss RD 47–RD 49 for the income year [see 540.295]; and

(b) The company’s FBT liability in relation to the person under s RD 50 for the income year [see 540.300].

This applies when:

(a) The person is an employee of a company in which the person and associated persons hold, in total, voting interests of 50 per cent or more or, if a market value circumstance exists, market value interests of 50 per cent or more; and

(b) The company provides a fringe benefit that must be attributed to the person under s RD 47.

(13) **Deposits in main income equalisation accounts [s MB 9]**

A person’s family scheme income for an income year includes the amount deductible under s DQ 1 for a deposit into the person’s main income equalisation account for an accounting year corresponding to the same tax year as does the income year. This applies for the person’s own business, as well as:

(a) A company that meets the requirements of s MB 4 for the person’s family scheme income to be affected by net income of the company for the accounting year;
(b) A trustee of a trust that meets the requirements of s MB 7 for the person’s family scheme income to be affected by net income of the trustee for the accounting year;

(c) A company in which a trustee referred to in paragraph (b) and associated persons hold a voting interest of 50 per cent or more, or a market value interest of 50 per cent or more (if a market value circumstance exists).

(14) **Amounts derived by dependent children [s MB 11]**
A person’s family scheme income includes the amount by which the total income derived by a dependent child of the person from the following sources exceeds $500:

(a) Resident passive income;
(b) Royalties;
(c) Rent;
(d) Beneficiary income that is not referred to in s HC 35(4)(b)(i), (ii) or (v) [see 1420.60];
(e) Attributed income from a PIE that is not a superannuation fund or retirement savings scheme;
(f) A distribution from a listed PIE.

(15) **Other payments [s MB 13]**
A person’s family scheme income for an income year includes the value of payments paid or provided to the person from any source and used by the person to replace lost or diminished income of the person or the person’s family, or to meet usual living expenses of the person or the person’s family, but does not include:

(a) A loan under ordinary commercial terms and conditions;
(b) A payment from an amount that is:
   (i) Proceeds of the disposal of property; and
   (ii) Not assessable income of the person disposing of the property;
(c) A payment on behalf of the person by a local authority or public authority;
(d) A forgiveness of debt by a public authority;
(e) A charitable distribution from a charitable entity registered under the Charities Act 2005;
(f) An educational scholarship;
(g) A student loan under the Student Loan Scheme Act 1992;
(h) A grant for the payment of expenses relating to medical treatment or a funeral;
(i) A payment under an insurance contract, other than a payment for a loss of income;
(j) Compensation for a loss other than a loss of income;
(k) Lump sum compensation under the Accident Compensation Act 2001;
(l) A monetary benefit under the Social Security Act 1964 that is exempt income;
(m) A pension or allowance under the War Pensions Act 1954 that is exempt income;
(n) A payment that is exempt income under s CW 33(1)(c), (e), or (f);
(o) An amount that is declared not to be income for the purposes of the Social Security Act 1964 by a regulation under s 132 of that Act;
(p) A payment included in the family scheme income of the person under another section;
(q) A payment expressly excluded from the family scheme income of the person under another section.
(r) A payment to relieve the adverse effects of an event declared by the CIR to be an emergency event, where the payment is made in the period (maximum 12 months) set by the CIR for that event under s 91AAS of the TAA. (This applies, for example, to the Canterbury earthquakes of 4 September 2010 and 22 February 2011).
If the total of the payments that would otherwise be included under s MB 13 in the family scheme income for the income year of the person and their spouse, civil union partner or de facto partner does not exceed $5,000, the payments are not included in the person’s family scheme income.

420.65 Allowance of tax credit in end-of-year assessment [ss LA 4, LA 7, MF 5, MF 6; TAA, ss 41, 80KU, 80KV]

Every person entitled to a working for families (WFF) tax credit or a minimum family tax credit is required to furnish a return of income each year [TAA, s 41(4)]. A tax credit may be set off against any tax payable by the person for the tax year, so far as that tax extends, and any balance remaining is refunded [s BC 8(2)]. Any tax credits that have been incorrectly allowed on an instalment basis during the tax year may be corrected when the annual tax assessment is made for the taxpayer.

A credit of tax is not allowed for a child if the caregiver has not provided the CIR with the child’s tax file number (IRD number) or birth certificate, or other evidence verifying the birth or existence of the child.

A person who has been given a notice of entitlement for a tax year must, in the time within which they are required to file their return of income for the tax year, give the CIR a complete statement of their family scheme income for the tax year, including that of a spouse, civil union partner or de facto partner, as applicable [TAA, s 80KV].

1) Recovery of overpaid tax credit [s MF 5]

Where an abating WFF tax credit or a minimum family tax credit set off or refunded to a person is more than the proper amount, the CIR may recover the excess as if it were income tax payable by the person. If the person is in a relationship with a spouse, civil union partner or de facto partner, the person and that spouse or partner are jointly and severally liable for paying the excess.

2) Overpayment or underpayment of tax credit [s MF 6; TAA, 80KLB]

When a person, who is entitled to an abating WFF tax credit or a minimum family tax credit, has the tax credit paid by instalment:

(a) Any overpayment is added to the tax payable by the person for the tax year, and is recoverable by the CIR under s 80KLB of the TAA, as if it were tax payable by the person for the year.

(b) Any underpayment is used to satisfy the person’s income tax liability, and any balance remaining is treated as tax paid in excess and available for use under s LA 7(2) [see 1395.15].

A person is not liable for a shortfall penalty in relation to a credit the CIR is entitled to recover if the offset or refund was in excess of the proper amount because:

(a) The person applied by an annual return and before 1 April 2007 for a credit of tax;

(b) At the time of the application, the person was eligible to be a transitional resident [see 370.35]; and

(c) Before 1 June 2007, the person gave notice to the CIR that they did not wish the application to be treated as an election under s HR 8(4)-(6).

420.70 Tax credits paid by instalments [ss MF 1, MF 2, MF 3, MF 4; TAA, ss 80KA–80KH]

Any person entitled to an abating WFF tax credit or a minimum family tax credit may apply on form FS1 for the amount to be received in interim weekly or fortnightly instalments. The application must be in the prescribed form and must be signed by the applicant and, if applicable, their spouse. The application must:

(a) Give, for each signatory, a complete statement of the net income that is expected to be attributable to the applicable tax year and elected period;

(b) Elect whether interim instalments are to be paid weekly or fortnightly;

(c) Contain such other information as the CIR may require; and

(d) Be accompanied by the supporting evidence described below.

The supporting evidence required to accompany the application is:
(a) Evidence of employment income (if any) derived during the month immediately preceding the date of application;
(b) If the signatory expects to derive business income, any one of the following:
   (i) A copy of the financial statements of the business for the tax year (or corresponding income year) immediately preceding the relevant tax year;
   (ii) If the financial statements referred to in (i) have not been completed, a copy of the financial statements of the business for the tax year (or corresponding income year) before the immediately preceding the relevant tax year;
   (iii) A set of budgeted accounts of the business for the relevant tax year (or corresponding income year);
   (iv) Other evidence acceptable to the CIR in relation to the business for the relevant tax year (or corresponding income year);
(c) The tax file number (IRD number) of each child for whom a credit is claimed;
(d) In the case of a child who has died or been given up for adoption, a birth certificate or other evidence verifying the birth or existence of the child for whom a credit is claimed.

A person who is entitled to receive the parental tax credit may apply to receive the credit by way of weekly or fortnightly interim instalments. The application must be made within three months after the date of the dependent child’s birth. If the application is not made within three months, the credit can be received only by way of a credit in the person’s end of year assessment in the tax year in which the birth occurs. The parental tax credit is explained in 420.40.

If the three-month application period spans two tax years and the period of entitlement (56 days) falls entirely in the first tax year, but all the interim instalments are paid in the second tax year, the period of entitlement (“selected period”) is treated, for family assistance purposes, as falling in the second tax year.

If an IRD number is not provided, the interim instalments apply for a period of only eight weeks, and then cease until the information is provided.

On receipt of the application, the CIR determines the estimated tax credit entitlement and issues a notice of entitlement to the person specifying:
(a) The amount of the weekly or fortnightly interim instalment;
(b) The amount contributed by the family tax credit;
(c) The amount contributed by the in-work tax credit;
(d) The amount contributed by the child tax credit;
(e) The amount contributed by the parental tax credit; and
(f) The amount contributed by the minimum family tax credit.

Amounts (b) to (e) are the amounts after abatement. The CIR retains a copy of the notice of entitlement and arranges for payment of the interim instalments [see 420.80].

Any person who expects to receive an income-tested benefit is not entitled to apply for interim instalments of abating WFF tax credit. Work and Income New Zealand instead makes appropriate provisions.

A person holding a notice of entitlement for interim instalments must advise the CIR immediately, in writing, when any of the following occurs:
(a) The holder commences or ceases to be the principal caregiver or the spouse of a principal caregiver of any child, where it is expected this will last for more than 56 consecutive days;
(b) The holder commences or ceases to be a spouse for another person;
(c) Any event happens which is specified in the notice of entitlement;
(d) Any other event happens that the person considers may affect his or her entitlement to the tax credit; or
(e) The notice of entitlement is lost or destroyed.

The CIR may also require an incorrect notice to be returned for cancellation or replacement. A certificate of entitlement is not transferable, is invalid if altered, and is subject to the terms and conditions stipulated thereon. If it is withdrawn it shall be surrendered within seven days.

420.75 When Work and Income New Zealand delivers tax credits [TAA, ss 80KN, 80KO, 80KP, 80KQ, 80KR, 80KS, 80KT]

When Work and Income New Zealand (WINZ) pays a person an income tested benefit, it must, at the same time, pay the amount of the working for families (WFF) tax credit the person is entitled to. If the family credit abatement is greater than nil, WINZ can only pay the credit if it is authorised to do so by an Order in Council made under the TAA, s 225A. WINZ uses the methods set out in ss MD 3, MD 13 and MF 3 to calculate the amount of WFF tax credit payable.

When WINZ ceases to pay to a person an income-tested benefit it will, if the person applies, continue to pay to the person, for a period determined by WINZ in consultation with the CIR, a credit of tax determined as if the person were still being paid an income-tested benefit during the period.

WINZ may request the CIR to accept from a person an application for a notice of entitlement if it is satisfied that the person is entitled to a credit of tax but WINZ is not authorised to pay it. WINZ may, any time after making such a request to the CIR, request the CIR to cease making payments to the person if WINZ subsequently becomes authorised to pay the credit.

A person who is entitled to the tax credit may notify WINZ not to pay the tax credit in this way. Later, that notification may be cancelled by the payee and WINZ would then recommence payment of the tax credit as soon as practicable. Where WINZ makes the payment either to the person or to a spouse and is not otherwise required to deliver a tax deduction certificate, then it shall:

(a) On or before 20 April following the end of the tax year in which the payment is made, deliver to the person a summary showing the total of all of the amounts of the tax credits paid along with any other information required by the CIR; and

(b) On or before the following 31 May, deliver to the CIR a copy of every such summary delivered.

WINZ must also provide Inland Revenue with payment details in an employer monthly schedule.

420.80 When CIR delivers tax credits by instalments [TAA, ss 80KI, 80KJ, 80KK, 80KL, 80KM, 80KU]

When a notice of entitlement to receive the abating WFF tax credit or minimum family tax credit by interim instalments has been issued to a person, the tax credits must be paid to the person by Inland Revenue in weekly or fortnightly instalments for the period of entitlement.

The CIR must deliver to the recipient a summary showing the total of all tax credits paid to the person by instalment during the tax year. The summary must be delivered:

(a) For a non-filing taxpayer, on or before 20 May following the end of the tax year; or

(b) For a filing taxpayer, on the same day as the CIR issues the person with an income statement [see 1270.75].

The CIR may start paying interim instalments before a notice of entitlement is issued if the CIR considers that the issue of the certificate has been unduly delayed.

If WINZ ceases paying a person a credit of tax (eg if the person ceases to qualify for an income-tested benefit), the CIR will, on application by the person, continue to pay the balance of the person’s entitlement for the remainder of the entitlement period.

The CIR normally requires the person receiving the instalments to supply the details of a bank account into which the CIR pays the instalments. The bank account may be held either in the person’s name alone or jointly with their spouse.
**420.85 Overpayments resulting from additional pay day** [TAA, s 80KW]

Persons receiving the WFF tax credit or the minimum family tax credit by instalment during the year are required to make a square-up calculation at the end of the tax year and repay any overpayment.

If a person who is entitled to a WFF tax credit or a minimum family tax credit receives 27 fortnightly or 53 weekly instalments of the credit, s 80KW of the TAA adjusts the amount of the credit accordingly.

**420.90 Anti-avoidance** [ss MA 6, GB 44]

Where an arrangement is made between a person (the claimant) and another person, the purpose of which is to obtain a more favourable working for families (WFF) tax credit or minimum family tax credit than would otherwise have occurred, the CIR may reduce the claimant’s tax credit to eliminate the advantage.
Chapter 430
Farmers

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430.05 Types of livestock [s EC 1]

For valuation purposes, livestock is divided into four categories. These are:

(a) Specified livestock: sheep, dairy cattle, beef cattle, deer, goats and pigs [see column 1 of sch 8], but excluding high-priced livestock that is not subject to a bailment. The six types of specified livestock are then further divided into classes of livestock such as “mixed age cows” or “rising 2-year heifers”;

(b) High-priced livestock: sheep, cattle, deer, goats and pigs [see column 1 of sch 17], which is capable of being used for breeding or expected to be capable of breeding when it reaches maturity and which is purchased for not less than:

   (i) $500; and

   (ii) Five times the national average market value at the end of the year of purchase in the income year of purchase or the previous income year whichever is greater. The relevant national market value is the national market value for the class [see column 2 of sch 17], in which the livestock is able to be classified at the end of the income year in which it was purchased;

(c) Non-specified livestock: all livestock other than specified livestock, high-priced livestock, and bloodstock; and

(d) Bloodstock: a horse that is a member of the standard bred or thoroughbred breed of horses. The term includes a share or interest in such a horse.

430.10 Definitions [ss EC 27, YA 1]

The following terms are used in this Chapter.

1. Short-term bailment

   A “short-term bailment” is a bailment or lease under which all of the following apply:

   (a) At the time at which the bailor delivers the livestock to the bailee, the bailor expects to have the same livestock delivered back;

   (b) The bailee or lessee did not provide consideration to the bailor for the delivery of the livestock; and

   (c) The term of the bailment or lease ends on or before the end of the income year following the income year in which the arrangement is made.

2. Long-term bailment

   A “long-term bailment” is a bailment or lease under which, at the time at which the bailor delivers the livestock to the bailee, the bailor does not expect to have the same livestock delivered back at the end of the bailment. Generally the bailment agreement will specify that the same number of livestock of the same class and quality are to be returned.

3. Profit-sharing arrangement

   “Profit-sharing arrangement” means an arrangement under which all of the following apply:

   (a) A person (Person A) makes specified livestock available, without specifying a fee for doing so, to another person (Person B) who carries on a business in which the livestock are used;

   (b) Any return or compensation that Person A receives for making the livestock available depends on the profits of the business;

   (c) Person A participates in the profits and losses of the business; and
(d) If a partnership between Person A and Person B arises, Person A is bound by the requirements of the Partnership Act 1908 for third parties.

430.15 Valuation of livestock generally [ss EC 2, EC 3, EC 4, EC 5]

All livestock is required to be valued using a method available under subpart EC. That value becomes the closing value for the purposes of the trading stock regime and the opening value for the following income year.

Where a taxpayer dies on or after 1 October 2005, the provisions of ss FC 1 to FC 7 apply to determine the value of livestock as at the date of death [see 1420.197].

Special rules apply where livestock is transferred between companies in a wholly-owned group. The company holding the livestock at balance date (Company B) is able, if it so wishes, to value it at the cost to the group company which originally acquired it (Company A). All of the following conditions must be met:

(a) At all times since the livestock was originally acquired, it has been held by a company which is a member of the same wholly-owned group and which is resident in New Zealand;

(b) At the end of the income year, both Company A and Company B remain members of the same wholly-owned group; and

(c) Company A and Company B have the same balance date, or have the CIR’s approval to use different balance dates on the basis that this is necessary to prevent the material distortion of net income that would result from income and allowable deductions for a single business cycle being reported in different income years.

If Company A and Company B cease to be members of the same wholly-owned group, Company B is deemed to have sold the livestock for its market value and to have immediately reacquired it at the same price. Any profit or loss arising on the deemed sale is thus realised for tax purposes when the livestock is transferred out of the wholly-owned group of companies.

Section EC 5 deals with livestock that is donated or supplied to a taxpayer by a non-associated person at less than market value for use in a farming or agricultural business that is affected by a “self-assessed adverse event”. A “self-assessed adverse event” is defined as a drought, fire, flood, or other natural event, or livestock disease or sickness, that materially affects the business. The event must be described by the taxpayer to the CIR by way of statutory declaration. Where this occurs, the livestock leaves the business of the donor or supplier, and enters the business of the recipient at the amount received from the recipient (which may be zero).

430.20 Valuation of specified livestock [s EC 7]

The valuation methods available for specified livestock are as follows:

(a) Herd scheme;

(b) National standard cost; and

(c) Cost price, replacement price or market value.

Special rules apply to bailed livestock.

Taxpayers must elect which method they wish to use. The election is made by using the method in their return of income. The election then continues in force until another alternative method is chosen. There are restrictions on the circumstances under which a person can elect to use a different method.

If the taxpayer fails to make a valid election, the CIR is able to determine, in consultation with the taxpayer, the method to be used.

430.25 Herd scheme for specified livestock

Under the herd scheme, livestock is valued at the National Average Market Value (NAMV) for its class. The NAMVs are set each year and are designed to reflect the average market values throughout New Zealand as at 30 April.
Both the opening and closing stock is valued at the NAMV for the year. Thus, changes in livestock values do not affect income for tax purposes. Changes in livestock numbers do affect income for tax purposes.

430.30 Restrictions on using the herd scheme [s EC 8]

It is not necessary to value all livestock on hand under the herd scheme. However, there are two requirements that must be met:

(a) The number of animals of a particular class valued under the herd scheme cannot be less than:
   (i) The number on hand as at balance date; or
   (ii) The number valued under the herd scheme in the previous income year, whichever is less.

(b) All male breeding stock must be valued under the herd scheme where national standard cost scheme or the cost price scheme is also being used in the same income year.

430.35 Herd valuation [ss EC 16, EC 17, EC 18, EC 19, EC 20, EC 21]

Livestock on hand at the end of the income year is valued at the herd value for that class of livestock.

To the extent to which the opening stock was valued under the herd scheme in the previous income year and was on hand at the beginning of the income year, its opening value is the herd value for the income year. Thus, movements in NAMVs do not affect income for tax purposes. Changes in livestock numbers do affect income for tax purposes.

Taxpayers are able to elect to adopt a “herd value ratio” for livestock of a particular type. The “herd value ratio” allows a taxpayer to value livestock at a value that more accurately reflects their own market value taking into account such things as stock quality and regional variations. If a herd value ratio has been adopted, the herd values are multiplied by the herd value ratio. It is calculated following an assessment by a recognised livestock valuer of the average head of stock in each class. The formula is:

\[ \frac{\sum (\text{average value} \times \text{number})}{\sum (\text{herd value} \times \text{number})} \]

Where:
- “\(\Sigma\)” is the total of the individual calculations for all applicable classes of livestock valued under the herd scheme.
- “Average value” is the average value of an animal in a class.
- “Number” is the number of all livestock of that class on hand at the end of the income year including livestock not in the herd scheme but excluding high-priced livestock.
- “Herd value” is the NAMV livestock of that class.

The result is then rounded to the nearest of the following: 0.9, 1.0, 1.1, 1.2, 1.3. The effect of using the herd value ratio is that livestock is brought to account at 90 per cent, 100 per cent, 110 per cent, 120 per cent or 130 per cent of NAMVs.

The CIR has the power to require a person to recalculate the herd value ratio where it is felt that the ratio being used is inaccurate.

A special ratio, referred to as the “Chatham Islands adjustment” applies to the Chatham Islands. This is set by the CIR.

Where the taxpayer ceases to derive income from specified livestock and herd livestock is disposed of before the 1 February preceding the determination of NAMVs for the year, the taxpayer may choose to value the herd livestock that has been disposed of at the previous year’s value. This would be advantageous if NAMVs are expected to fall.

Similarly, where a person dies and the herd livestock owned by that person is sold before 1 February preceding the determination of the herd values for the year, and the person’s return of income is filed before the values are determined, the person may adopt the previous year’s values. This overrides the general position of livestock being required to be valued at market value in the return to date of death.
430.40 National average market values [ss EC 15; TAA, s 91AAE]

The CIR is required to make determinations of national average market values for each class of specified livestock listed in column 2 of sch 17. The values shown in the determination apply to an income year, whether that income year commenced before, on, or after the date on which the determination is made.

The national average market values of specified livestock for the following income years are:

<table>
<thead>
<tr>
<th>Type of livestock</th>
<th>Classes of livestock</th>
<th>2007-08</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>SHEEP</td>
<td>Ewe hoggets</td>
<td>52.00</td>
<td>94.00</td>
<td>88.00</td>
<td>120.00</td>
</tr>
<tr>
<td></td>
<td>Ram and wether hoggets</td>
<td>49.00</td>
<td>88.00</td>
<td>81.00</td>
<td>107.00</td>
</tr>
<tr>
<td></td>
<td>Two-tooth ewes</td>
<td>60.00</td>
<td>116.00</td>
<td>122.00</td>
<td>160.00</td>
</tr>
<tr>
<td></td>
<td>Mixed-age ewes (rising 3-year and 4-year-old ewes)</td>
<td>50.00</td>
<td>99.00</td>
<td>107.00</td>
<td>142.00</td>
</tr>
<tr>
<td></td>
<td>Rising 5-year and older ewes</td>
<td>41.00</td>
<td>81.00</td>
<td>88.00</td>
<td>124.00</td>
</tr>
<tr>
<td></td>
<td>Mixed-age wethers</td>
<td>32.00</td>
<td>56.00</td>
<td>65.00</td>
<td>99.00</td>
</tr>
<tr>
<td></td>
<td>Breeding rams</td>
<td>190.00</td>
<td>218.00</td>
<td>237.00</td>
<td>353.00</td>
</tr>
<tr>
<td>BEEF CATTLE</td>
<td>Beef breeds and beef crosses:</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Rising 1-year heifers</td>
<td>333.00</td>
<td>429.00</td>
<td>448.00</td>
<td>509.00</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year heifers</td>
<td>547.00</td>
<td>663.00</td>
<td>680.00</td>
<td>786.00</td>
</tr>
<tr>
<td></td>
<td>Mixed-age cows</td>
<td>638.00</td>
<td>770.00</td>
<td>791.00</td>
<td>997.00</td>
</tr>
<tr>
<td></td>
<td>Rising 1-year steers and bulls</td>
<td>427.00</td>
<td>534.00</td>
<td>566.00</td>
<td>599.00</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year steers and bulls</td>
<td>640.00</td>
<td>748.00</td>
<td>791.00</td>
<td>883.00</td>
</tr>
<tr>
<td></td>
<td>Rising 3-year and older steers and bulls</td>
<td>801.00</td>
<td>908.00</td>
<td>915.00</td>
<td>1049.00</td>
</tr>
<tr>
<td></td>
<td>Breeding bulls</td>
<td>1,464.00</td>
<td>1,743.00</td>
<td>1,799.00</td>
<td>1,931.00</td>
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<tr>
<td>DAIRY CATTLE</td>
<td>Friesian and related breeds:</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>Rising 1-year heifers</td>
<td>1,037.00</td>
<td>511.00</td>
<td>691.00</td>
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<td></td>
<td>Mixed-age cows</td>
<td>2,150.00</td>
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<td></td>
<td>Rising 1-year steers and bulls</td>
<td>292.00</td>
<td>381.00</td>
<td>393.00</td>
<td>459.00</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year steers and bulls</td>
<td>480.00</td>
<td>576.00</td>
<td>635.00</td>
<td>767.00</td>
</tr>
<tr>
<td></td>
<td>Rising 3-year and older steers and bulls</td>
<td>664.00</td>
<td>724.00</td>
<td>773.00</td>
<td>998.00</td>
</tr>
<tr>
<td></td>
<td>Breeding bulls</td>
<td>1,062.00</td>
<td>1,220.00</td>
<td>1,101.00</td>
<td>1,370.00</td>
</tr>
<tr>
<td></td>
<td>Jersey and other dairy cattle:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Rising 1-year heifers</td>
<td>920.00</td>
<td>434.00</td>
<td>575.00</td>
<td>792.00</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year heifers</td>
<td>1,702.00</td>
<td>953.00</td>
<td>1,014.00</td>
<td>1,344.00</td>
</tr>
<tr>
<td></td>
<td>Mixed-age cows</td>
<td>2,079.00</td>
<td>1,243.00</td>
<td>1,275.00</td>
<td>1,631.00</td>
</tr>
<tr>
<td></td>
<td>Rising 1-year steers and bulls</td>
<td>225.00</td>
<td>322.00</td>
<td>335.00</td>
<td>363.00</td>
</tr>
<tr>
<td>Type of livestock</td>
<td>Classes of livestock</td>
<td>2007-08</td>
<td>2008-09</td>
<td>2009-10</td>
<td>2010-11</td>
</tr>
<tr>
<td>------------------</td>
<td>----------------------</td>
<td>---------</td>
<td>---------</td>
<td>---------</td>
<td>---------</td>
</tr>
<tr>
<td>DEER</td>
<td>Rising 2-year and older steers and bulls</td>
<td>478.00</td>
<td>577.00</td>
<td>557.00</td>
<td>616.00</td>
</tr>
<tr>
<td></td>
<td>Breeding bulls</td>
<td>884.00</td>
<td>998.00</td>
<td>984.00</td>
<td>1140.00</td>
</tr>
<tr>
<td></td>
<td><strong>DEER</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><em>Red deer:</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Rising 1-year hinds</td>
<td>152.00</td>
<td>272.00</td>
<td>201.00</td>
<td>253.00</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year hinds</td>
<td>309.00</td>
<td>460.00</td>
<td>350.00</td>
<td>420.00</td>
</tr>
<tr>
<td></td>
<td>Mixed-age hinds</td>
<td>363.00</td>
<td>514.00</td>
<td>410.00</td>
<td>481.00</td>
</tr>
<tr>
<td></td>
<td>Rising 1-year stags</td>
<td>198.00</td>
<td>318.00</td>
<td>240.00</td>
<td>297.00</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year and older stags (non-breeding)</td>
<td>421.00</td>
<td>530.00</td>
<td>385.00</td>
<td>469.00</td>
</tr>
<tr>
<td></td>
<td>Breeding stags</td>
<td>1,064.00</td>
<td>1,393.00</td>
<td>1,257.00</td>
<td>1,218.00</td>
</tr>
<tr>
<td></td>
<td><strong>Wapiti, elk, and related crossbreeds:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Rising 1-year hinds</td>
<td>186.00</td>
<td>318.00</td>
<td>254.00</td>
<td>305.00</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year hinds</td>
<td>347.00</td>
<td>484.00</td>
<td>397.00</td>
<td>466.00</td>
</tr>
<tr>
<td></td>
<td>Mixed-age hinds</td>
<td>399.00</td>
<td>551.00</td>
<td>460.00</td>
<td>535.00</td>
</tr>
<tr>
<td></td>
<td>Rising 1-year stags</td>
<td>229.00</td>
<td>366.00</td>
<td>306.00</td>
<td>352.00</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year and older stags (non-breeding)</td>
<td>415.00</td>
<td>574.00</td>
<td>456.00</td>
<td>537.00</td>
</tr>
<tr>
<td></td>
<td>Breeding stags</td>
<td>1,146.00</td>
<td>1,678.00</td>
<td>1,322.00</td>
<td>1,409.00</td>
</tr>
<tr>
<td></td>
<td><strong>Other breeds:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Rising 1-year hinds</td>
<td>100.00</td>
<td>80.00</td>
<td>134.00</td>
<td>156.00</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year hinds</td>
<td>140.00</td>
<td>122.00</td>
<td>214.00</td>
<td>245.00</td>
</tr>
<tr>
<td></td>
<td>Mixed-age hinds</td>
<td>176.00</td>
<td>153.00</td>
<td>256.00</td>
<td>265.00</td>
</tr>
<tr>
<td></td>
<td>Rising 1-year stags</td>
<td>109.00</td>
<td>85.00</td>
<td>162.00</td>
<td>185.00</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year and older stags (non-breeding)</td>
<td>188.00</td>
<td>152.00</td>
<td>255.00</td>
<td>291.00</td>
</tr>
<tr>
<td></td>
<td>Breeding stags</td>
<td>432.00</td>
<td>340.00</td>
<td>525.00</td>
<td>638.00</td>
</tr>
<tr>
<td>GOATS</td>
<td><strong>Angora and Angora crosses (mohair producing):</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Rising 1-year does</td>
<td>26.00</td>
<td>20.00</td>
<td>57.00</td>
<td>65.00</td>
</tr>
<tr>
<td></td>
<td>Mixed-age does</td>
<td>41.00</td>
<td>25.00</td>
<td>73.00</td>
<td>84.00</td>
</tr>
<tr>
<td></td>
<td>Rising 1-year bucks (non-breeding)/wethers</td>
<td>23.00</td>
<td>10.00</td>
<td>42.00</td>
<td>56.00</td>
</tr>
<tr>
<td></td>
<td>Bucks (non-breeding)/wethers over one year</td>
<td>26.00</td>
<td>12.00</td>
<td>55.00</td>
<td>61.00</td>
</tr>
<tr>
<td></td>
<td>Breeding bucks</td>
<td>86.00</td>
<td>64.00</td>
<td>240.00</td>
<td>379.00</td>
</tr>
<tr>
<td></td>
<td><strong>Other fibre and meat producing goats (Cashmere or Cashgora producing):</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Type of livestock | Classes of livestock | 2007-08 | 2008-09 | 2009-10 | 2010-11
--- | --- | --- | --- | --- | ---
Rising 1-year does | 41.00 | 28.00 | 62.00 | 61.00
Mixed-age does | 48.00 | 29.00 | 71.00 | 82.00
Rising 1-year bucks (non-breeding)/wethers | 29.00 | 23.00 | 44.00 | 53.00
Bucks (non-breeding)/wethers over 1-year | 29.00 | 18.00 | 52.00 | 61.00
Breeding bucks | 240.00 | 168.00 | 305.00 | 386.00
Milking (dairy) goats:
Rising 1-year does | 180.00 | 180.00 | 160.00 | 150.00
Does over one year | 260.00 | 260.00 | 230.00 | 250.00
Breeding bucks | 350.00 | 350.00 | 330.00 | 300.00
Other dairy goats | 50.00 | 50.00 | 50.00 | 18.00
PIGS
Breeding sows less than one year of age | 195.00 | 154.00 | 219.00 | 200.00
Breeding sows over one year of age | 219.00 | 179.00 | 295.00 | 280.00
Breeding boars | 262.00 | 190.00 | 310.00 | 329.00
Weaners less than 10 weeks of age (excluding sucklings) | 56.00 | 52.00 | 75.00 | 72.00
Growing pigs 10 to 17 weeks of age (porkers and baconers) | 121.00 | 87.00 | 142.00 | 129.00
Growing pigs over 17 weeks of age (baconers) | 168.00 | 126.00 | 208.00 | 192.00

430.45 National standard cost for specified livestock

The national standard cost valuation method values purchased livestock at its purchase cost. Livestock bred on the farm are valued at the first balance date following birth at the breeding, rearing and growing (BRG) value for the type and class. Animals carried to the next balance date have rearing and growing (RG) costs added. With the exception of male non-breeding cattle, all animals are considered mature after the second year and no further costs are added to their value. Male non-breeding cattle are considered mature after the third year.

The BRG and RG costs are published each year.

430.50 Restrictions on using national standard cost [s EC 9]

There are five restrictions on the use of the national standard cost (NSC) scheme. These are as follows:

(a) NSC is not available to a taxpayer where the taxpayer also values livestock under the cost price method.

(b) NSC is not available to a taxpayer where, in the previous income year, the taxpayer valued specified livestock under the cost price method and has not given at least two income year’s notice to the CIR of an election to use NSC.

(c) NSC is not available in respect of a type of livestock where the taxpayer makes livestock available to another person under a profit-sharing arrangement and that other person values livestock of that type under the cost price method. This restriction also applies where there is another (third) person who has made livestock available under that profit-sharing arrangement and that third person values livestock of that type under the cost price method.
Farmers

(d) NSC is not available for livestock which is bailed or leased to another person under a long-term bailment.
(e) NSC is not available in an income year if the CIR has made a determination that precludes the use of NSC for that livestock.

430.55 National standard cost values
The national standard cost values of specified livestock for the following income years are:

<table>
<thead>
<tr>
<th>Kind of livestock</th>
<th>Category of livestock</th>
<th>2007-08</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>SHEEP</td>
<td>Rising 1-year</td>
<td>23.00</td>
<td>26.00</td>
<td>24.20</td>
<td>28.20</td>
<td>28.30</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year</td>
<td>15.70</td>
<td>17.80</td>
<td>16.10</td>
<td>18.40</td>
<td>19.80</td>
</tr>
<tr>
<td>DAIRY CATTLE</td>
<td>Purchased bobby calves</td>
<td>167.20</td>
<td>176.90</td>
<td>152.40</td>
<td>168.70</td>
<td>186.70</td>
</tr>
<tr>
<td></td>
<td>Rising 1-year</td>
<td>608.60</td>
<td>787.60</td>
<td>428.00</td>
<td>394.40</td>
<td>473.30</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year</td>
<td>104.80</td>
<td>142.60</td>
<td>91.00</td>
<td>85.20</td>
<td>93.80</td>
</tr>
<tr>
<td>BEEF CATTLE</td>
<td>Rising 1-year</td>
<td>228.30</td>
<td>261.60</td>
<td>242.20</td>
<td>282.90</td>
<td>302.10</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year</td>
<td>132.30</td>
<td>150.00</td>
<td>135.70</td>
<td>155.00</td>
<td>166.70</td>
</tr>
<tr>
<td></td>
<td>Rising 3-year male non-breeding cattle (all breeds)</td>
<td>132.30</td>
<td>150.00</td>
<td>135.70</td>
<td>155.00</td>
<td>166.70</td>
</tr>
<tr>
<td>DEER</td>
<td>Rising 1-year</td>
<td>76.90</td>
<td>91.80</td>
<td>78.30</td>
<td>94.40</td>
<td>109.80</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year</td>
<td>37.40</td>
<td>44.50</td>
<td>39.40</td>
<td>48.00</td>
<td>52.80</td>
</tr>
<tr>
<td>GOATS (MEAT &amp; FIBRE)</td>
<td>Rising 1-year</td>
<td>18.40</td>
<td>20.90</td>
<td>19.00</td>
<td>21.60</td>
<td>23.20</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year</td>
<td>12.60</td>
<td>14.30</td>
<td>13.00</td>
<td>14.80</td>
<td>15.90</td>
</tr>
<tr>
<td>GOATS (DAIRY)</td>
<td>Rising 1-year</td>
<td>134.50</td>
<td>155.50</td>
<td>124.70</td>
<td>132.60</td>
<td>146.60</td>
</tr>
<tr>
<td></td>
<td>Rising 2-year</td>
<td>21.50</td>
<td>25.20</td>
<td>20.50</td>
<td>21.20</td>
<td>24.40</td>
</tr>
<tr>
<td>PIGS</td>
<td>Weaners to 10 weeks of age</td>
<td>85.50</td>
<td>93.10</td>
<td>97.60</td>
<td>90.40</td>
<td>94.70</td>
</tr>
<tr>
<td></td>
<td>Growing pigs 10-17 weeks of age</td>
<td>67.40</td>
<td>75.20</td>
<td>81.20</td>
<td>74.90</td>
<td>75.90</td>
</tr>
</tbody>
</table>

TaxNotes:
(1) Animals born on farm are recorded at their published value at the end of year 1.
(2) Animals purchased in their first or second year of life are recorded for that year at purchase cost.
(3) Where animals are carried over to their second year of life, the published rearing and growing costs for rising 2-year animals of that category must be added to their year-1 value.
(4) As male non-breeding cattle are considered not mature until the third year, the published rearing and growing costs for rising 3-year animals must be added to their year-2 value.
(5) Animals carried over to their third year of life (fourth year for male non-breeding cattle), remain on hand at their prior year value with no further costs required to be added.

Example:
Farmer Brown commences farming in 20X1. He purchases the following livestock:

- 500 mixed age ewes @ $50 = $25,000
- 500 mixed age ewes @ $60 = $30,000
- 20 rams @ $200 = $4,000
Farmers

500 ewe lambs @ $80

$40,000

At the end of the 20X1-X2 income year the livestock is brought into closing stock at as follows:

<table>
<thead>
<tr>
<th>Quantity</th>
<th>NSC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mixed age ewes</td>
<td>1000</td>
</tr>
<tr>
<td>Ewe hoggets</td>
<td>500</td>
</tr>
<tr>
<td>Rams</td>
<td>20</td>
</tr>
</tbody>
</table>

$55,000

$40,000

$4,000

In the 20X2-X3 income year, 1500 lambs are born and survive. All other stock survive the year. No further stock are purchased.

At the end of the 20X2-X3 income year the livestock is brought into closing stock at as follows:

(a) The mixed age ewes retain their original average purchase price as their NSC;
(b) The rams retain their purchase price as their NSC;
(c) The ewe hoggets have rearing and growing costs added; and
(d) The lambs are brought to account at their breeding rearing and growing cost.

Using the 2009-2010 determination to illustrate (rising 1 year sheep breeding, rearing and growing costs of $24.20, rising 2 year sheep rearing and growing costs of $16.10) the closing values for the 20X2-X3 income year would be:

<table>
<thead>
<tr>
<th>Quantity</th>
<th>NSC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mixed age ewes</td>
<td>1000</td>
</tr>
<tr>
<td>Rising 2th Ewes</td>
<td>500</td>
</tr>
<tr>
<td>Rams</td>
<td>20</td>
</tr>
<tr>
<td>Hoggets</td>
<td>1500</td>
</tr>
</tbody>
</table>

$55,000

$48,050

$4,000

$36,300

430.60 Valuation of specified livestock at cost price, market value, or replacement price [s EC 25, EC 10]

Taxpayers are able to value specified livestock at any one of cost price, market value or replacement price. Use of cost price is subject to certain restrictions.

Where a taxpayer changes in the income year to the cost price method from another method, the opening value of livestock is the closing value from the previous income year calculated under that other method.

There are five restrictions to the use of the cost price method. They are:

(a) The cost price method is not available to a person if, in the same income year, they value specified livestock under the national standard cost scheme.

(b) The cost price method is not available where, in the previous income year, they valued specified livestock under the national standard cost scheme and have not given two income years’ notice to the CIR in the prescribed manner of their election to adopt the cost price method.

(c) The cost price method is not available to value specified livestock that is bailed or leased to another person except where that bailment is under a profit-sharing arrangement.

(d) The cost price method is not available in an income year where the specified livestock has been bailed or leased to another person under a long-term bailment or under a short-term bailment between associated persons for other than fair market value.

(e) The cost price method is not available to value a type of specified livestock in an income year in which the person has made specified livestock available under a profit-sharing arrangement to another person who values any livestock under the national standard cost scheme. This restriction also applies where there is another (third) person who has made livestock available under that profit-sharing arrangement and that third person values livestock of that type under the national standard cost scheme.
430.65 Valuation elections for specified livestock [ss EC 11, EC 12, EC 13]

There are a number of elections required under the various methods for the valuation of specified livestock. Some are able to be made in the income year to which they relate. Others must be made two years in advance. The various elections are described below

(1) Same year elections

An election must be made by the date on which the person files the return of income for the income year in which the election is first to apply:

(a) To value livestock of a particular type under the herd scheme; or

(b) To adopt a herd value ratio or the Chatham Islands adjustment for livestock of any type if the income year is the first income year in which the particular livestock is valued under the herd scheme.

(2) Two years' prior notice

Notice is required by the date on which the person files the return of income for the income year that is at least two years prior to the first income year in which any one or more of the following elections is to apply:

(a) To cease valuing any particular type of specified livestock under the herd scheme unless the person continues to value some livestock of that type under the herd scheme or when another valuation method is available (eg where there is an excess of livestock numbers over the number required to be valued under the herd scheme);

(b) To adopt a herd value ratio, recalculated herd value ratio or Chatham Islands adjustment for any livestock unless it is the first year in which the herd scheme has been used;

(c) To move from the cost price method to the national standard cost scheme; or

(d) To move from the national standard cost scheme to the cost price method.

Any election once made is irrevocable in the first income year in which it applies. Elections continue to apply in all subsequent income years until superseded by a further election.

(3) Information requirements

Each notice of election must contain all of the following information:

(a) The income year in which it is first to apply;

(b) The type, class or other description of the livestock;

(c) The existing and proposed methods of valuing that livestock; and

(d) If the election is to use a herd value ratio or recalculated herd value ratio, the assessed value of an average animal of each applicable class of livestock, the date on which each animal was valued and the name and address of the valuer.

A valid election notice may state different valuation options for different classes of livestock within a type, but must state only one valuation option for any particular class of livestock.

(4) Joint elections

If livestock is owned jointly by two or more persons, the election regarding the valuation method to be used must be made jointly by all of the owners. In the absence of a valid election, the following applies:

(a) If the owners lease or bail the livestock to another person under the market value method, or enter into a profit-sharing arrangement under the market value method for the livestock, the market value method is required to be used; and

(b) In any other case, the national standard cost scheme applies.

(5) Profit-sharing arrangements

Where the national standard cost scheme or the cost price method is used to value livestock under a profit-sharing arrangement:
(a) The person who owns the livestock;
(b) The person who has the use of the livestock; and
(c) Any other person who has made livestock of the same type available to the person who has the use of the livestock,
are treated as the single owner of the livestock.
This means that parties to the arrangement must use the same valuation method.

(6) **Partnerships**
A person’s partnership interest in livestock is treated separately from any other livestock interest that the person may have. Separate elections are required for the person’s partnership interest and for their other interests. It is not necessary for the same valuation methods to be used for the partnership as are used for the other interests.

(7) **Changes in partnership interests**
Where the make-up of a partnership is changed and at least 50 per cent of the property of the new partnership is owned by persons who:
(a) Owned all of the property of the old partnership; and
(b) Derived income from specified livestock of the same type as that owned by the new partnership,
in (either that income year or the previous income year) the new partnership must use the same valuation methods as were used by the old partnership.

430.70 **Bailed or leased specified livestock** [s EC 26]
A bailment occurs where the user of the livestock (the bailee) pays the owner of the livestock (the bailor) for the use of that livestock. It includes such things as lease arrangements and some sharefarming arrangements. It does not include a sharemilking arrangement.

Where a taxpayer (the bailee), has entered into a bailment, lease, or other agreement to use specified livestock (or any high-priced livestock) and is required under the agreement to return, or pay full compensation for, the livestock at a future date, the livestock is deemed to be owned by the taxpayer. Such livestock is required to be valued as at the end of each income year. The number of bailed livestock which must be returned as closing stock is calculated under the following formula:

\[
total \text{ livestock} - \text{bailed livestock}
\]

Where:
“Total livestock” is all of the livestock that the bailee has on hand at the end of the income year. It includes both livestock that is owned by the person and livestock that they have use of under the bailment, lease or other agreement.

“Bailed livestock” is the total number of livestock of that class that the taxpayer has been given the use of under the bailment, lease, or other agreement that, as at the end of the income year, is still in force.

Under the formula, the livestock that are subject to the bailment are deducted from the number of livestock on hand. Where this results in a positive number, it is a bailment surplus and the bailee is treated as owning that surplus. Where it results in a negative number, it is a bailment deficiency which means that the bailee has a future liability to make good those deficiencies. The livestock number on hand in this case in negative.

430.75 **Valuation of high-priced livestock** [ss EC 32, EC 33, EC 34, EC 35, EC 36, EC 37]
“High-priced livestock” means any sheep, cattle, deer, goat or pig, where all of the following apply:
(a) The cost of the animal is $500 or more;
(b) The purchase price was not less than five times the national average market value for that class of livestock for either the end of the year of purchase or at the end of the immediately preceding income year; and
(c) The animal was (at the time of purchase), capable of being used for breeding or expected to be capable of being used upon maturity.

The high-priced livestock regime is based on depreciation of the livestock over its breeding life. The scheme applies only to purchased livestock. Livestock that are bred are required to be valued under one of the other valuation regimes. Under the high-priced livestock regime, taxpayers have the option of using either a straight line depreciation rate or a diminishing value rate. The diminishing value rate is set at:

\[ 1.5 \times \text{the straight line rate} \]

If the diminishing value method is chosen, the taxpayer is required to give notice to the CIR at the time of filing their return of income for the first income year in which the high-priced livestock is taken into account. Once the choice has been made, it cannot be revoked.

The rates are set by the CIR having regard to the:

(a) Average cost of that type or class or category of livestock;
(b) Estimated useful life of the livestock; and
(c) Estimated average residual market value of the livestock.

The following rates currently apply:

<table>
<thead>
<tr>
<th>Livestock category</th>
<th>Straight line equivalent rate</th>
<th>Diminishing value rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sheep</td>
<td>25%</td>
<td>33%</td>
</tr>
<tr>
<td>Cattle</td>
<td>20%</td>
<td>26%</td>
</tr>
<tr>
<td>Stags</td>
<td>20%</td>
<td>26%</td>
</tr>
<tr>
<td>Other deer</td>
<td>15%</td>
<td>22%</td>
</tr>
<tr>
<td>Goats</td>
<td>20%</td>
<td>26%</td>
</tr>
<tr>
<td>Pigs</td>
<td>33%</td>
<td>40%</td>
</tr>
</tbody>
</table>

No write-down of high-priced livestock is available in the year of purchase where the animal is not more than one year of age at the end of the income year of purchase. Writedown in the year of purchase is also prohibited where the animal is purchased within six months of the end of the income year and, within that period:

(a) If male livestock, has not been used for insemination or semen collection; or
(b) If female livestock, has not given birth or had ova removed.

High-priced livestock must be transferred to another livestock valuation regime where either or both of the following apply:

(a) The value of the livestock to be taken into account at the end of the income year is equal to or less than the national average market value applying to livestock of that class; or
(b) The livestock is no longer expected to be used for breeding purposes for that or any subsequent income year, and the taxpayer has no intention of selling or otherwise disposing of the livestock to any other person to be used for breeding purposes.

430.80 **Valuation of non-specified livestock** [ss EC 29, EC 30, EC 31]

The term “non-specified livestock” is defined in s YA 1 as any livestock that is not specified livestock, high-priced livestock or bloodstock. It includes, horses (other than bloodstock), emus, alpacas, rabbits and dogs.

The taxpayer has the option of valuing any non-specified livestock to be taken into account at the end of any income year at its cost price, market value, replacement price, or (with the concurrence of the CIR) its standard value. The CIR may from time to time determine standard values for any type or category of non-specified livestock.
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430.80(1)

Where a taxpayer undertakes new or expanded production of non-specified livestock and purchases additional non-specified livestock for that purpose, any write-down to standard value is required to be spread over three income years [s EC 31].

(1) Valuation of ostriches and emus

The CIR has published an interpretation statement on the valuation of ostriches and emus for income tax purposes in TIB vol 9:8 (August 1997) at 11-21.

430.85 Valuation of livestock generally and on sale of property

In TRA Case B15 (1975) 2 NZTC 60,112 and Land Projects Ltd v Commissioner of Inland Revenue [1964] NZLR 723 (SC), it was held that all livestock, coming within the natural and ordinary meaning of that word and which is an asset of a farming business, is regarded as trading stock.

The general principle, arising from the judgments of the New Zealand Courts (and approved by the Privy Council) in the case of Hansen v Commissioner of Inland Revenue [1973] 1 NZLR 483 (PC), is that, in the case of a sale of a farm as a going concern, the value of the livestock to be taken into account by both the vendor and the purchaser for income tax purposes is the market value of the livestock as at the date when possession of the farm property is given to the purchaser. However, should the total of the market values of the farm property and the livestock as at that date exceed the total consideration payable by the purchaser for the farm property and the livestock, the value of the livestock to be taken into account by both the vendor and the purchaser is the market value as above of the livestock scaled down in accordance with a formula which may be expressed as follows:

\[
\frac{a}{b} \times c
\]

Where:

- \(a\) is the market value of the livestock as at the date when possession of the farm property is given to the purchaser;
- \(b\) is the total of the market values of the farm property and the livestock as at the date when possession of the farm property is given to the purchaser; and
- \(c\) is the total consideration payable by the purchaser for the farm property and the livestock.

For simplicity in the above formula, other assets included in the sale have been omitted. In practice they would also come into the calculation.

430.87 Treatment of livestock where partners enter and exit a partnership

Special rules apply where partners enter and exit a partnership. They apply where the disposal of a partner’s interest in a partnership includes livestock of the following types:

(a) Specified livestock that is not valued using the herd scheme or one of the cost price, replacement price, or market value methods under s EC 25; and

(b) Non-specified livestock.

430.90 Carcasses on hand at balance date

The freezing company, with sales on “owner’s account”, does not purchase the stock but processes it on the farmer’s behalf and later sells it for the farmer. Immediately after killing, the freezing company pays an advance to the farmer of between 75 per cent and 90 per cent of the schedule values of the stock. When the carcasses are sold, the farmer is paid the balance. At no stage does ownership of the livestock (or carcasses) pass to the freezing company. The value of carcasses on hand and held by agent freezing companies prior to sale overseas should be included in calculating income. The CIR has ruled that the value to be adopted at balance date should not be less than 75 per cent of the schedule price at balance date. Sales made through a pool account where an advance is received are treated differently and the amount of any such advance should be returned as income in the year in which the advance is received.
430.95   **Group livestock breeding schemes**

Group breeding schemes entered into by farmers to improve the quality of their flocks are usually carried on with the group being registered under the Companies Act 1993, the Incorporated Societies Act 1908, or the Industrial and Provident Societies Act 1908. Groups so registered are “companies” for tax purposes. Such a group is a legal entity and a separate taxpayer from its members. The principle of mutuality is not applied in these circumstances.

If registered under the Companies Act 1993 or the Industrial and Provident Societies Act 1908, payments from members for share capital are not assessable to the group, but levies to meet a group’s trading expenses are income. If the group is incorporated under the Incorporated Societies Act 1908, entrance fees are not assessable but levies to meet trading deficits are assessable to the group. From the individual members’ point of view, share capital contributions and entrance fees paid to the group are non-deductible, but subscriptions to meet expenses are deductible. The group’s income, calculated in the normal way, is assessable whether the sales are made to members or others. Allowable deductions are calculated in the normal way.

A member who sells livestock to the group is assessable on the sale price, and the group deducts the cost as a purchase. Conversely, a member buying stock from the group deducts the cost, and the group treats the transaction as a sale.

Ewes contributed to the group by a member become the property of the group and the member usually receives one ram in return for a certain number of ewes. A member who buys a ram from the group in excess of the member’s entitlement must make the purchase at a realistic market price. The closing stock on hand at the end of the year is determined as follows:

(a) Ewes contributed to the group by a member should be excluded from the member’s stock on hand; 
(b) Rams received in exchange should be included in the member’s closing stock at the value adopted for flock rams; and 
(c) Ewes contributed by members are included as part of the group’s closing stock at the value adopted by the group for its ewe flock.

430.100   **Wool industry — restructuring**

The Wool Board Restructuring Act 2003 provides for the restructuring of the wool industry by dissolving the New Zealand Wool Board and, as of 15 September 2003, converting it into a company called Wool Board Disestablishment Company Ltd. The company assumes the Board’s assets and liabilities and is required to oversee the disbursement of the net assets to wool growers.

The Act contains a number of provisions that ensure that wool growers suffer no tax effects from the restructuring. In particular, s 36 provides that the issue of shares to a wool grower does not constitute a dutiable gift, a dividend or assessable income of any other kind. Section 36 further provides that proceeds from the sale, exchange, redemption or other disposition of a share, other equity or similar instrument is not income for tax purposes [see TIB vol 15:9 (September 2003) at 28-30].

430.105   **New start grants** [ss CX 48, EW 46; TAA, s 177D]

The new start grant programme was introduced as part of Government’s disaster relief package for farmers. The scheme relates to persons engaged in the following industries:

(a) Animal husbandry; 
(b) Poultry keeping; 
(c) Beekeeping; 
(d) Breeding horses other than bloodstock; 
(e) Horticulture; or 
(f) Cropping.

The grant must relate to an “emergency event” (previously referred to as a “qualifying event”). An emergency event is an event that has been declared by the Governor General to be an emergency event. The purpose of
the provision is to remove from income the remission of a liability where that remission is a prerequisite for a new-start grant being made.

The criteria are as follows:

(a) The taxpayer incurs a liability before the declaration of the state of emergency is made;
(b) The liability is deductible within three months following the end of the state of emergency;
(c) The liability is remitted within 18 months following the end of the state of emergency as a prerequisite for payment of the new-start grant; and
(d) That remission would be taxable to the taxpayer under s CG 2 (remitted amounts).

Where these criteria are met, the remission is excluded income of the taxpayer to the extent to which the result of the following formula is more than zero:

\[
\text{remitted amount} - \text{current loss} - \text{loss balance} - \text{other loss}
\]

Where:

“Remitted amount” is the amount of the remitted liability.
“Current loss” is the amount of the net loss that the taxpayer would have for the income year of remission.
“Loss balance” is any loss balance that the person has. These are generally losses brought forward from earlier income years.
“Other loss” is a loss incurred by an associated person of the taxpayer where the following criteria are met:

(a) The associated person carries, or has carried, on the business for which the grant is paid or owns, or has owned, the land used in the business (either freehold or leasehold); and
(b) The associated person is under a substantial degree of control by the taxpayer and has substantial identity interests with the taxpayer; and
(c) The loss is incurred from the business and/or the land is used in the business.

The loss incurred by the associated person is taken into account only to the extent to which the CIR determines and the CIR is required to provide the associated person with a written notice of determination.

The effect of the formula is that, while the remission may result in the taxpayer forfeiting losses, it will not result directly in additional tax payable.

A similar treatment applies under the financial arrangement rules where a business loan is taken out prior to the declaration of a state of emergency that relates to an emergency event. Where the loan is remitted within 18 months following the end of the state of emergency and as a prerequisite for the payment of a new start grant, the remitted amount is deemed to have been paid to the extent to which it is allowed under the formula described above. The same associated persons provisions as described above also apply.

Under s 177D of the TAA, the CIR must grant relief to any taxpayer to whom a new start grant is payable or to an entity that is associated with the taxpayer, to the extent that the CIR thinks appropriate. The relief is from the unpaid tax that relates to an income tax liability arising from:

(a) The farming business for which the new start grant was paid;
(b) Land used in carrying on the farming business; or
(c) The sale of the farm.

The amount of the relief is calculated as if the relevant income was the only income derived. This is relevant where the taxpayer’s income tax liability is calculated other than at a flat rate of tax.

If the new start grant relates to a declared emergency event, the CIR is required to grant additional relief to the taxpayer in respect of the payment of unpaid tax or amounts owing under the PAYE rules. These liabilities must relate to the farming business for which the new start grant was paid.

430.110 Farming or agricultural business defined

In determining whether a particular activity or enterprise is a farming or agricultural business, it is necessary to consider:

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(a) Whether the activity or enterprise constitutes a business for tax purposes; and
(b) Whether the business is carried on for farming or agricultural purposes.

The leading New Zealand case on the subject of whether a business is a farming or agricultural business is *Horniblow v Napier* [1955] NZLR 104 (SC), a case which did not involve income tax. Dicta in this case and several dictionary definitions were considered in *4 NZTBR Case 7* and the Board gave the following definition:

“So far as it is possible to distil a factor common to the citations or quotations we have made, it seems apparent that an agricultural business … would comprehend such uses of land as the cultivation thereof, the growing of crops, or the rearing of livestock thereon.”

A number of activities have been held to be outside the scope of the definition:

(a) Growing trees for production of timber (silviculture);
(b) Aerial top-dressing;
(c) Provision of services to persons themselves carrying on a farming or agricultural business (eg seed dressing, coolstores, agricultural contracting, etc);
(d) Dealing in livestock; and
(e) Bailment or leasing of livestock.

The CIR accepts that any of the following are activities carried on for farming or agricultural purposes:

(a) Agriculture — soil cultivation, cropping, animal husbandry;
(b) Horticulture — growing plants, shrubs and flowers;
(c) Orcharding — growing fruit;
(d) Viticulture — growing grapes;
(e) Apiculture — beekeeping;
(f) Poultry farming — keeping poultry.

Many of the concessions available to farmers depend upon the taxpayer being engaged in a farming or agriculture “business” (eg the deduction of development expenditure and the income equalisation scheme).

Can a taxpayer who is farming in a relatively small way in a rural retreat, often on a part-time basis, be said to be carrying on a farming “business” so as to claim the above concessions, and to set off any resulting losses against income from other sources? The decision in *Grieve v Commissioner of Inland Revenue* [1984] 1 NZLR 101, (1984) 6 NZTC 61,682, (1983) 6 TRNZ 461 (CA) presents the current state of the law in this area and held that the existence of a business depends upon the intention of the taxpayer. It is no longer appropriate to regard “intention” and “reasonable prospect” of profit as separate tests. The Court stated that the taxpayer’s prospect of profit is but one of the factors to consider in evaluating whether there is a genuine intention to make a profit.

PIB 118 (November 1982) contains a useful indication of the matters the CIR considers when determining the existence of a business:

“It is reasonable to expect that any person embarking on a genuine profit-making venture will make enquiries and investigations into the economic feasibility of the proposed activity and that the results of such enquiries will be adequately documented. The intentions for the property will generally be known before it is acquired and a property suitable for the activity in mind will be acquired. Investigations will no doubt have been made into the soil type or carrying capacity of the land if a farming or agricultural activity is contemplated. Expert advice may also have been obtained on the kinds of activities suitable for the property and how they should be carried on. Other factors such as the size and locality of the property and the time the taxpayer has available to devote to the activity are also relevant.”

If, for a year or two, the CIR allows losses claimed on the basis that the taxpayer’s activities amount to the carrying on of a “business” and later, in the light of further losses being returned, decides that there is now
no prospect of a profit being achieved and disallows the losses in the return for the year under review, it is generally not the CIR’s practice to apply the decision retrospectively and review assessments for the earlier years to disallow the losses previously allowed [see 130 BUSINESS].

430.115 **Other items of farmer’s income**

In addition to the net profit derived from the farming business, the income of a farmer includes the following:

(a) The value of meat and produce taken from the farm for private and domestic purposes.
(b) Prize money won at agricultural shows. Entrance fees and other expenses in connection therewith may be claimed as a deduction. As the prizes are not schedular payments, deduction of tax at the source of payment is not required.
(c) Rent for any portion of the farm let out, including grazing fees.
(d) Stud fees received.
(e) Compensation received for stock condemned. The book value of the stock would automatically be deducted in the process of accounting for livestock on hand at the end of the trading period.
(f) Compensation received for cattle slaughtered because of brucellosis [s CG 6].
(g) Compensation received for livestock lost in an adverse event. In *MacLean v Commissioner of Inland Revenue* (1985) 7 NZTC 5,035 (HC), the High Court confirmed that a grant from the Otago-Southland Flood Relief Trust Fund to a taxpayer as compensation for livestock lost during a flood was income. The Court held that the grant was received as compensation for loss of profits and had its basis in the market value of trading stock which had been destroyed. Compensation, indemnity, damages, or insurance proceeds for the loss or destruction of, or damage to, trading stock or any other article produced, manufactured, acquired, or purchased for the business of producing goods for sale or exchange is deemed to be income [s CG 6].
(h) Depreciation recovered on the sale of farming assets [s EE 40].
(i) Insurance proceeds on account of crop or stock losses [s EE 6].
(j) Proceeds from sale of timber [s CB 25].
(k) Income equalisation deposit scheme refunds plus interest thereon [subpart EH, see 440 FARMERS’ INCOME EQUALISATION SCHEME].
(l) Livestock and unsold wool or other produce on hand at balance date [ss EA 1, EB 3].
(m) Farm holidays for tourists. PIB 152 (September 1986) comments:

“The practice of providing farm holidays for tourists has now become well established on either a live-in basis or by providing separate accommodation with or without meals. The length of stay can vary from one night to an indefinite period. Any payments received for accommodation or food are liable for income tax. A record should be kept of all receipts and expenditure and any profits arising from the activity must be included in the recipient’s income tax return. The supply of accommodation and/or food is a service liable for GST.”

430.120 **Deductions in farmers’ tax returns**

The material in this paragraph does not constitute an exhaustive list of deductible or non-deductible farm expenditure. Rather, it is intended to serve as a guide to the treatment of some commonly incurred expenditure that is not discussed elsewhere. Expenses that are not allowable include:

(a) Depreciation of improvements to land, such as sheep dips, fences, yards, etc. Repairs are allowable as a deduction. Fences are able to be expensed under s DO 1 and a system of depreciation applies to expenditure on land improvements under sch 20 [ss DA 1, DA 2, DA 3, DO 1, DO 4 see 430.130].
(b) Money spent on permanent improvements to the land except to the extent it constitutes development expenditure provided for in s DO 1 or is expenditure on land improvements under s DO 4 [ss DA 2, DA 3, DO 1, DO 4 see 430.135].
(c) No deduction is permitted for any expenditure on, or depreciation of, a farmer’s dwelling where the dwelling is not situated on the farm property [s DA 2].

(d) Certain legal expenses [s DA 2].

(e) A farmer’s meal costs on sale days are private expenses and non-deductible: TRA Case H31 (1986) 8 NZTC 289.

Deductible expenses are in many cases subject to the prepaid expenditure provisions for unexpired expenditure at balance date. Deductible items may include:

(a) Legal expenses incurred in raising money to buy the farm, including the legal costs of raising mortgage moneys to finance the purchase of the farm and other income-producing assets. Legal costs such as conveyancing fees for the assets purchased are not allowed as they are part of the cost of the asset [ss DB 5, DB 18].

(b) Legal expenses incurred in connection with any lease or renewal of lease of property used in the production of income, and also expenses incurred in borrowing or renewing loan moneys employed as capital in the production of income [ss DB 5, DB 18].

(c) Telephone rentals and business tolls.

(d) Car expenses applicable to use in the business. The deduction for motor vehicle expenses may be restricted to a maximum of 25 per cent of expenditure claimed where adequate records of business and total mileage are not maintained. The requirement to maintain records does not apply where the vehicle is used 100 per cent for business purposes [ss DE 1 to DE 11].

(e) One-quarter of the depreciation, repairs, maintenance, insurance, and domestic power on a farmer’s own dwelling is deductible provided the dwelling is situated on the farm property.

In TRA Case K57 (1988) 10 NZTC 465 a husband and wife farming partnership successfully claimed dwelling house depreciation and outgoings of 25 per cent when the husband had other full-time employment and the wife taught part-time. Both worked with their family on the farm before and after work and at weekends.

(f) Maintenance costs for stockyards, sheep dips, and fencing. In the case of new stockyards, the cost of fencing may be claimed as development expenditure [ss DA 1, DO 1].

(g) Daily or weekly newspapers, providing stock reports or other farming information.

(h) A farmer is allowed a deduction of up to $7,500 per annum for expenditure incurred in planting or maintaining trees for shelter belts, erosion prevention, or for other agricultural or pastoral purposes or in erecting or maintaining fences to protect these trees. The concession excludes trees planted primarily for the production of fruit [s DO 3].

Expenditure incurred in planting “listed horticultural plants” is subject to a separate regime [see 430.120].

(i) Any taxpayer engaged in any farming or agricultural business on any land in New Zealand may elect in writing (under s EJ 3) to apportion the deduction for the expenditure incurred in the purchase and application of fertiliser and lime over the year in which the expenditure is incurred and the four succeeding years. The object of the provision is to encourage increased development of land by permitting the farmer to set off the expenditure in a later year when there is increased income arising from the application of the fertiliser and lime. The amount allocated may be determined with the passing of each year. Any balance remaining after the final year of the expenditure and the three following years is automatically deductible in the fourth year. The election for each year is to be made by way of notice to the CIR (an entry in the tax return suffices) within the period specified for furnishing the return. Once made, the election is irrevocable. Where a farmer ceases to carry on business, or dies, during the “spread” period, an election may be made by the farmer (or the personal representative) to have the balance not already deducted allocated either to the year in which the business ceased, or equally to the year of expenditure and the years up to and including that in which the business ceased. The CIR’s policy is set out in TIB vol 6:10 (March 1995) at 3-5.
(j) A farmer may deduct employer superannuation cash contributions paid to a superannuation fund or to a company (eg an unregistered superannuation scheme) for the benefit of employees. These contributions attract employer’s superannuation contribution tax (ESCT), or at the election of the employee, PAYE [ss DC 7, RD 65].

(k) Farmers are entitled to deduct from income the payments made to a housekeeper for cooking for permanent employees employed full time on the farm. A similar allowance is permitted to farmers making such payments to their spouse [see 960.10].

(l) A deduction is allowable for the costs of transporting an employee’s children to school. However, the claim excludes the cost of sending the farmer’s own children to school. Where the farmer personally provides the transport for the employee’s children, the petrol costs and other vehicle expenses are deductible in full against the farming income. Similarly, if the farmer contributes directly towards a transport service for employee’s children on a modified bus system, the cost of the contributions is allowable as a farm expense.

(m) In many rural areas, shelter trees used by farmers encroach on road reserves and foul overhead power lines. As an alternative to trimming or removing trees, some property owners are asked to contribute to the cost of putting the power reticulation system underground. Contributions made by farmers towards the cost of installing power underground are deductible.

(n) Farm sundries are consumable stores purchased to meet ordinary and continuous farming requirements and not held for resale. Examples are fertiliser held ready for spreading, stockfeed purchased or held for winter/summer use, and stock drenches. The full cost should be claimed in the year of purchase, provided payment or delivery occurs before balance date. They should be excluded from trading stock at balance date for tax purposes but are treated as consumable aids and subject to the prepaid expenditure rules if the value of the amount on hand at balance date exceeds $58,000.

The deductibility of farm sundries was confirmed in *TRA Case 90* (1982) 5 TRNZ 908, where the husband and wife taxpayers carried on a farming business in partnership. Together with another partnership they purchased a dairy farm. Included in the purchase were 6,000 bales of hay with a market value of $1.50 per bale. Part of the surplus hay was sold in 1978. A deduction was claimed for the value of the hay in their returns of income.

The CIR’s views on the tax treatment of conversions of land from one farming or agricultural purpose to another are set out in a operational statement in TIB vol 16:6 (July 2004) at 18-30. The CIR’s views on the deductibility of items of expenditure relating to dairy farming are set out in TIB vol 12:2 (February 2000) at 10-41.

The following additional points should be noted:

(a) Generally, farmers’ aerial mapping costs are capital expenditure and not deductible. However, the costs may be associated with land improvements.

(b) The following guidelines may be used when considering deductibility of a proportion of the cost of a swimming pool available for fighting fires in farm dwellings and adjacent farm buildings:

   (i) When the pool is built primarily as a swimming pool no deduction is allowable, the expenditure being of a private or domestic nature.

   (ii) When the pool is built partly for farming purposes and partly for private purposes, the expenditure can be apportioned as to private and business content. Depending on the aspects of the business use that portion of the cost is capitalised and depreciated.

   (iii) Proximity to house, elaborateness, and the nature of ancillary equipment are the elements to consider when deciding the private expenditure content.

(c) The cost of spray type sheep dips may be depreciated.

(d) Artificial shelter surrounding and subdividing horticultural blocks and used as a cover over sensitive crops is to be treated in the following manner:
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(i) If erected as a windbreak around the boundary of a horticultural block it is accepted as within the meaning of “fences”;
(ii) If erected to protect trees planted to provide shelter, prevent erosion, or otherwise for agricultural purposes is acceptable as coming within the $7,500 deduction allowed by s DO 7;
(iii) Artificial shelter which is more than a fence, eg it provides cover over a crop, is not regarded as a “fence” and is not deductible. However, depreciation is allowed on those structures constructed on land for shelter purposes [under s DO 4].

(e) Forestry. As forestry is not a farming or agricultural business, any plant or machinery bought for the purposes of a forestry business does not qualify: TRA Case D5 (1979) 3 TRNZ 198.

(f) In some cases, land is developed by taxpayers before commencing a farming or agricultural business but with the intention of ultimately doing so. It has been the CIR’s practice to defer the deduction in all cases where the taxpayer is not in receipt of farming income. A case where a deduction was claimed but denied is TRA Case G36 (1985) 7 NZTC 1,133. It was held that the development expenditure was not deductible because the taxpayer was not carrying on a farming or agricultural business on that land in the relevant income year. However, this situation does not arise where the taxpayer is an established farmer. In such a case, the deduction is allowed in the year claimed, despite the fact that the block under development may be separate from the regular farm and has not yet produced any farming income.

(g) The treatment of regrassing and fertiliser expenditure incurred on or after 1 July 2004 has been clarified by way of legislative amendment. Section DO 1 now provides that pasture regrassing and fertilising is fully deductible in the year in which the expenditure is incurred unless it is incurred in the course of a “significant capital activity”. The term “significant capital activity” is defined in s YA 1 as an activity that enables a change in the nature or character of a farming activity but excludes an activity that enables a change in the intensity of farming practice (eg a change in pasture type to accommodate an increase in stocking intensity). Where the expenditure is incurred in the course of a significant capital activity, it is able to be amortised under s DO 4 at the rate of 45 per cent diminishing value. Expenditure on pasture that has an estimated useful life of one year or less is able to be deducted in the year in which it is incurred regardless of whether or not it is incurred in the course of a significant capital activity.

(1) Depreciation on farm buildings

Depreciation is allowable on farm buildings and dwellings situated on the farm.

Where the owner lives in the dwelling, the depreciation allowable is 25 per cent of the depreciation calculated on the cost of the dwelling provided the owner is a full-time farmer.

Where the owner has some other income-earning activity and the farming activity is carried on part-time, the proportion of the depreciation allowable on the dwelling should be calculated in accordance with the degree or extent to which the dwelling is actually used in the farming business.

Where a partnership dwelling is occupied by a partner (other than a partner with a minor interest), 25 per cent of the depreciation on the cost price of the house occupied by the partner and one-quarter of the repairs and maintenance and domestic power is allowable as a deduction in arriving at the income of the partnership. However, a greater proportion may be deductible in certain circumstances, as indicated in TRA Case F47 (1983) 6 NZTC 59,801, which concerned a farming partnership of six persons which owned a large sheep station. Two of the partners, who were entitled to 12.5 per cent of the profits each, lived in the farm homestead. A dispute arose as to the deductibility of the dwelling expenses and depreciation against farming income. It was held that at least 75 per cent of the expenditure and depreciation could not be expenditure of a private nature and was therefore deductible. This apportionment was based on the percentage of profits allocated to partners not living on the farm. The remaining 25 per cent was regarded as the cost incurred to enable the continuance of the administrative base of the farm as well as provide a home for the two partners living on the property. In the opinion of the TRA, a reasonable apportionment of the remaining 25 per cent, was 50 per...
cent of a business nature with the remaining 50 per cent being of a private and domestic nature. Accordingly, 87.5 per cent of the dwelling expenditure and depreciation was deductible from farming income and the remaining 12.5 per cent was added back, being of a private nature. As a result of this decision it would now appear that the CIR’s administrative 75:25 apportionment ratio (in the case of a sole-proprietor farmer) may not be the most appropriate for partnerships where some of the partners do not live on the property.

When a taxpayer occupies a farm dwelling owned by a trust, and the taxpayer or spouse is the settlor, a quarter of the rental applicable to that building is allowed as a deduction against the taxpayer’s farming income. The following formula is used to determine the amount of rental applicable to the dwelling:

\[
\frac{a \times b}{c}
\]

Where:

- \(a\) is cost price of dwelling as used for depreciation purposes by the trust;
- \(b\) is cost price of farm; and
- \(c\) is annual rental for the property including dwelling.

The essence of the adjustment is to identify the portion of total rent paid for the farm (including the homestead) which relates to private and therefore non-deductible expenditure for the dwelling.

When a farmer leases a farming property from an “associated person”, a similar adjustment should also be made.

Depreciation on the furniture of an owner-occupied farm dwelling cannot be claimed except in the case of furniture of an office used exclusively for business purposes. Depreciation on furniture is allowable where an employee occupies a furnished dwelling.

Where existing or new stockyards are covered with a roof of permanent materials the cost of the roof should be capitalised and depreciation claimed as for other farm buildings.

**430.125 Farmers’ capital expenditure [ss DO 1, DO 2, DO 3]**

Any taxpayer engaged in any farming or agricultural business on any land in New Zealand is entitled to a deduction of the amount of any expenditure incurred by the taxpayer in that income year for enhancements to land, erosion and shelter planting, and tree planting or maintenance. Each of the three categories of expenditure has different requirements before a deduction is allowed.

All three categories require the person be engaged in farming on land in New Zealand. However, expenditure for enhancements to land and for tree planting or maintenance, requires the expenditure be for things on the farm land, whereas erosion and shelter planting expenditure does not need to be for things on the farm land (ie trees can be planted outside of the farm land). In addition, expenditure for planting or maintaining trees requires that the farming business is the principal business activity on that land. Expenditure on tree planting and maintenance under s DO 3 also has an annual monetary limitation. These requirements are summarised in the table below.

<table>
<thead>
<tr>
<th>Category</th>
<th>Engaged in farming</th>
<th>Expenditure for things on land</th>
<th>Principle activity</th>
<th>Monetary limitation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enhancements to land</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Erosion and shelter planting</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Tree planting and maintenance</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

(1) **Enhancements to land [s DO 1]**

The following amounts are deductible where the expenditure is incurred on enhancements to the land (except trees) on which the farming or agricultural business is carried on:
Farmers

(a) The destruction of weeds or plants detrimental to the land;
(b) The destruction of animal pests detrimental to the land;
(c) The clearing, destruction, and removal of scrub, stumps, and undergrowth;
(d) The repair of flood or erosion damage;
(e) The construction on the land of fences for agricultural purposes, including the purchase of wire or wire-netting for the purpose of making new or existing fences rabbit-proof; and
(f) The regrassing and fertilising of pasture where the expenditure is not incurred in the course of a “significant capital activity”.

The term “significant capital activity” is defined in s YA 1 as an activity that enables a change in the nature or character of a farming activity but excludes an activity that enables a change in the intensity of farming practice (eg change in pasture type to accommodate an increase in stocking intensity).

(2) **Erosion and shelter plantings [s DO 2]**

In order for the following amounts to be deductible, it is only necessary that the taxpayer be carrying on a farming or agricultural business on land in New Zealand. The deduction is allowed whether or not the trees are planted on that land:

(a) The planting and maintaining of trees for the purpose of preventing or combating erosion of the land;
(b) The planting and maintaining of trees for the purpose of providing shelter to the land.

The deduction is allowed whether or not the trees are planted on that land.

(3) **Trees on farm [s DO 3]**

Under s DO 3, a deduction is allowed for the cost of planting or maintaining of trees on the land other than:

(a) Trees for which the person is allowed a deduction under s DO 2 (see above); or
(b) Trees planted mainly to produce fruit; or
(c) Trees planted under a forestry encouragement agreement under the Forestry Encouragement Act 1962.

The deduction is limited as follows:

(a) In an income year in which the person incurs expenditure on planting trees on the land, the maximum deduction is the lesser of $7,500 and the expenditure incurred; and
(b) In an income year in which the person incurs expenditure on maintaining trees on the land, the maximum deduction is the lesser of $7,500 and the expenditure incurred.

In order for the deduction to be available, the farming or agricultural business must be the principal business carried on the land.

**TaxNote:** Where there is an overlap between types of expenditure which are fully deductible under ss DO 1, DO 2 or DO 3 and those which are able to be amortised under s DO 4, taxpayers are required to take the immediate deduction [see 430.130].

**430.130 Expenditure on land improvements [ss DO 4, DO 10, DO 11, DZ 13]**

Any taxpayer carrying on a farming or agricultural business in New Zealand may claim a deduction for any expenditure of the types listed below which is incurred in preparing or otherwise developing land and is of benefit to the business in that income year. The provision excludes: expenditure incurred on listed horticultural plants [see 430.135], expenditure on avoiding, remedying or mitigating effects of the discharge of a contaminant [see 230.95], improvements to forestry land [see 520.40], or improvements to aquacultural businesses [see 500.30]. Each of these has its own regime.

Sections DO 4 and DO 10 state that expenditure incurred by the taxpayer that owns the land or by any other taxpayer qualifies for the deduction. The expenditure must comply with all of the following conditions:

(a) Be of the type listed in the schedule;
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(b) Not be immediately deductible under any of ss DO 1, DO 2, or DO 3;
(c) Have been incurred in relation to the land owned or leased by the taxpayer;
(d) Have been incurred in the 1995-1996 or later income year;
(e) Not have been incurred in the year in which the land is sold, or in the case of a lessee the year in which the person ceases to carry on business on the land;
(f) Be incurred in developing the land; and
(g) Be of benefit to the business in the year in which the deduction is allowed.

The words “or by any other taxpayer” mean that a taxpayer who owns land on which a farming or agricultural business is carried on is able to claim a deduction in relation to qualifying expenditure incurred by a previous owner of the land. The amount of the deduction is the relevant percentage of the diminished value of that expenditure (ie the amount of expenditure originally incurred less all previous deductions in relation to that expenditure) [see TES 6 (July 2003) 87].

Example:
Farmer A owned a farm, and in the 20X1 income year, spent $20,000 constructing an access road to the back of his farm. In that year Farmer A would be entitled to a deduction of five per cent of $20,000 (which is $1,000).
In the 20X2 income year, Farmer A sold his farm to Farmer B. In the 20X2 income year, Farmer B spent $10,000 building a landing strip for top dressing. Therefore, in the 20X2 income year, Farmer B can claim a deduction for both:
(a) Five per cent of the diminished value of the expenditure incurred by Farmer A (ie five per cent of $20,000 − $1,000, which is $950).
(b) Five per cent of the expenditure he incurred himself (ie five per cent of $10,000, which is $500).

The deduction allowed is the amount equal to the percentage specified in sch 20, Part A of the “diminished value” of the item of expenditure (see table below). “Diminished value” means the amount of the expenditure reduced by every amount allowed as a deduction in any preceding year in respect of that expenditure, and every amount allowed as a deduction in the current income year under other provisions in the Act.

Expenditure on farming improvement

<table>
<thead>
<tr>
<th>Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>The preparation of the land for farming or agriculture</td>
<td>6%</td>
</tr>
<tr>
<td>Regrassing and fertilising pasture in the course of a significant capital activity that relates to a type of pasture with an estimated useful life of more than one year</td>
<td>45%</td>
</tr>
<tr>
<td>The draining of swamp or low-lying lands</td>
<td>6%</td>
</tr>
<tr>
<td>The construction of access roads or tracks to or on the land</td>
<td>6%</td>
</tr>
<tr>
<td>The construction of dams, stopbanks, irrigation or stream diversion channels, or other improvements for the purpose of conserving or conveying water for use on the land or for preventing or combating soil erosion, other than planting or maintaining trees, whether or not on the land, for the purpose of providing shelter to the land</td>
<td>6%</td>
</tr>
<tr>
<td>The construction of earthworks, ponds, settling tanks, or other similar improvements primarily for the purpose of the treatment of waste products in order to prevent or combat pollution of the environment</td>
<td>6%</td>
</tr>
<tr>
<td>The sinking of bores or wells for the purpose of supplying water for use on the land</td>
<td>6%</td>
</tr>
<tr>
<td>The construction of aeroplane landing strips to facilitate aerial top-dressing of the land</td>
<td>6%</td>
</tr>
<tr>
<td>The planting of non-listed horticultural plants on the land</td>
<td>12%</td>
</tr>
<tr>
<td>The erection on the land of electric power lines or telephone lines</td>
<td>12%</td>
</tr>
<tr>
<td>The construction on the land of feeding platforms, feeding yards, plunge sheep dips, or self-feeding ensilage pits</td>
<td>12%</td>
</tr>
<tr>
<td>The construction on the land of supporting frames for growing crops</td>
<td>12%</td>
</tr>
</tbody>
</table>

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Expenditure on farming improvement

The construction on the land of structures for shelter purposes 12%

The remaining value of any improvement that is destroyed, or irreparably damaged, rendering it useless for the purposes of deriving income, may be written-off where the person would otherwise have been allowed a deduction in respect of that improvement under s DO 4 or s DO 10. In order for the deduction to be claimed, the damage must not result from the action or inaction of the taxpayer, taxpayer’s agent or an associated person of the taxpayer. The deduction is available in respect of the 2005-2006 and subsequent income years [s DO 11].

The remaining value of any improvement that was destroyed or made useless as a result of February 2004 floods or the July 2004 Bay of Plenty storm is able to be written-off if the taxpayer would otherwise have been allowed a deduction in respect of that improvement under s DO 4 or s DO 10 [s DO 11].

If vines or trees have ceased to exist or have ceased to be used in the production of assessable income, their remaining value may be written-off and a deduction claimed for that amount. For the tax treatment of listed horticultural plants see 430.135.

Expenditure on listed horticultural plants [ss DO 4, DO 5, DO 6, DO 7, DO 8, DO 9, DO 10, DV 14]

Historically, the tax treatment of replacement plantings of horticultural plantings such as orchards has been uncertain. Certain types of horticultural plant now have their own amortisation and deduction rules. The types of plants included in the rules are specified by the CIR. Thirty five categories of plant have been included in the list [see 5000.50]. Trees planted for timber production, ornamental trees or grape vines planted for wine production are not included. The commencement date for the revised tax treatment is the beginning of the 2003-2004 income year. Vines, trees and other plants not covered by the rules continue to be covered by s DO 4 [see 430.150].

The regime provides for:

(a) Amortisation of plantings;

(b) Immediate deduction for replacement plantings to a maximum of 15 per cent of the planting in any three-year period with a maximum of 7.5 per cent of the planting in any income year; and

(c) Write off of plants which cease to exist or cease to be used as part of the business where that plant is not replaced.

To qualify for the new rules, the taxpayer must carry on a farming or agricultural business on land in New Zealand and the land must have been developed by way of planting listed horticultural plants. The term “farming or agricultural business” includes horticulture.

(1) Amortisation [s DO 5]

Expenditure incurred on acquiring and planting the types of plant listed in the CIR’s determination is to be amortised at the rates stated in the determination [see 5000.50]. The rates are based on the estimated useful life of the plants. The only exception to this rule is for expenditure incurred on replacement plantings to the extent to which that expenditure can be deducted in the income year in which it is incurred. Non-listed horticultural plants continue to be amortised at 12 per cent per annum under s DO 4 and sch 20. If the taxpayer owns the land, no deduction is allowed in the income year in which the taxpayer disposes of the land. If the taxpayer does not own the land, no deduction is allowed in the income year in which the taxpayer ceases to carry on business on the land.

(2) Immediate deduction for replacements [s DO 6]

An immediate deduction is allowed for expenditure incurred on replacement planting to a maximum of 7.5 per cent of the area of the planting in any income year and 15 per cent in any three consecutive income years. Replacement plantings in excess of these limits must be capitalised and amortised. Replacement plantings include graftings. It is not necessary that the plant be replaced with a plant of the same type. Further, as the
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...deduction is based on the percentage of the area replaced, it is not necessary that the same number of plants be planted as replacements. Use of a different variety may mean that the plants are located closer together thereby increasing the number of plants in the area. There is no deduction available for the remaining cost of the original plant that has been replaced. Instead, it is allocated either to the replacement plants or to other plants as the taxpayer chooses [s DO 5(7)].

(3) **Immediate deduction for plants not replaced** [s DO 5(6)]

If a plant ceases to exist or ceases to be used to derive income, and is not replaced, a deduction is allowed for the part of the cost of the plant that has not yet been amortised.

(4) **Applying for a new or amended amortisation rate**

Where a horticultural plant has not been determined by the CIR as a listed horticultural plant, taxpayers may apply in writing to the CIR for a specific horticultural plant or category of horticultural plants to be so determined. The process is as follows:
Taxpayer applies in writing for a horticultural plant to be determined as a listed horticultural plan, or to amend the amortisation rate for an existing horticultural plant.

Is the application complete? (signed, information provided on the EUL of the horticultural plant and all information/explanations including amendment attached)

- No: IRD contacts the applicant and requests further information.
- Yes: If required, IRD contacts an independent industry expert to verify the EUL of the horticultural plant.

If required, the independent industry expert assesses the information provided by the applicant and provides IRD with their assessment of the EUL of the horticultural plant.

Does the independent industry expert's assessment agree with the applicant's?

- No: IRD advises the applicant that the industry expert's assessment differs to that provided. IRD also discusses the discrepancies with the applicant and/or the industry expert with a view to resolving the discrepancies.
- Yes: IRD proceeds to calculate an appropriate amortisation rate for the horticultural plant based on "Schedule 12 Banded rates of depreciation of the ITA 2007".

Inland Revenue Consultation Process

[1] Applicant advised of draft amortisation rate
[2] Internal IRD consultation for a period of 3 weeks
[3] General external consultation for a period of 6 weeks - required only if the applicant does not represent the whole industry to which the amortisation rate is to apply
[4] IRD reviews feedback and amends draft amortisation rate (where appropriate)
[5] IRD advises applicant of the new amortisation rate

Agreement reached on the estimated useful life of the horticultural plant? - applicant, industry expert and IRD

- No: Decision made by IRD on the horticultural plant's EUL
- Yes: IRD advises applicant of the new amortisation rate.

IRD publishes the new/revised listed horticultural plant amortisation rate in the next available TIB. IRD also notifies the public of the new/revised listed horticultural plant amortisation rate in the New Zealand Gazette.
430.140   Growing crops purchased with land  
Where crops that are still growing are purchased with the land and no separate price is allocated, they are treated for tax purposes as land and are not regarded as trading stock unless and until they are harvested. Consequently, no portion of the purchase price can be allowed as a deduction to the purchaser or assessed to the vendor as representing the value of trading stock at the date of sale. The definition of trading stock specifically excludes land. Where a separate price is specifically allocated to growing crops and to the land, that portion allocated to the growing crops is allowable as a deduction to the purchaser and represents income to the recipient.

430.145   Apiarists  
The hives of ordinary commercial beekeepers are a capital asset and not trading stock. They are regarded as plant and should be capitalised and depreciated [see 250 DEPRECIATION]. The cost of repairing or replacing hives which become dilapidated is fully deductible. The cost of replacement frames, whether plastic or wooden, is a deductible expense. The cost of frames for additional supers or hives or for a new beekeeper is capital expenditure and not deductible for tax purposes. The sale of hives by beekeepers who also deal in bees and hives, and the manufacture of hives for sale are treated as stock-in-trade.

430.150   Fruit grower’s costs of establishing orchard  
The purchase of land including legal expenses on purchase is capital expenditure and not deductible. However, if the land is merely leased, the cost of preparation of the lease is deductible. Expenditure incurred in raising money to purchase the land is also deductible. The cost of planting and maintaining shelter trees (but not the fruit trees) is deductible. There is a deduction for the cost of planting trees only where it indirectly promotes agriculture in the sense of promoting the use of the fields for growing purposes by providing shelter or by preventing erosion or something similar.

The planting of the fruit trees is not regarded as preparation of the land. It is part of the operation of fruit growing. Normally an orchardist buys and plants out trees from a nursery. Alternative schemes allow an orchardist to buy cuttings for a nominal cost and pay the nursery a “management fee” for caring and tending the cuttings until they are mature enough to transplant. The CIR considers that all costs incurred up to and including final planting are capital costs of establishing the orchard and therefore not deductible.

Until the trees reach fruit-bearing age, expenditure in cultivating, pruning, spraying, rates, insurance, depreciation, and similar recurring annual charges are deductible notwithstanding that they are incurred to earn profits in future years. If the deductible expenditure creates a loss, it is offset against other income of the taxpayer. Any amount not able to be offset against other income is carried forward and offset against profits in future years [see 940 LOSSES].

The Apple and Pear Marketing Board capital levy on new pipfruit production, designed to finance new capital facilities, is deductible in the income year in which it is incurred.

The following extract from TIB vol 7:1 (July 1995) presents the CIR’s policy on deductions for replacement, regrafting, and write off of vines and trees.

(1)   Replacement trees  
Schedule 7 refers to the “planting” of vines and trees and allows a deduction of 12 per cent on the diminished value of the expenditure. The CIR’s view is that “planting” means the initial planting at the establishment of an orchard, and any future replacement plantings when a particular species or variety is removed and replanted with a new species or variety. Schedule 7 refers to vines and trees rather than orchards. The CIR’s view is that the term “vines or trees” refers to vines or trees collectively, whether as a complete orchard or part of the orchard such as blocks or rows of trees. Any replacement plantings of any part of the orchard are a capital expense, and the cost must be capitalised to the orchard account and written-off at the rate specified in sch 7. The CIR allows a current year deduction only when a small number of vines or trees are replaced because they die or are destroyed. The number of trees and vines allowable as a current year deduction depends on the facts of each particular case, but is generally limited to replacing a small number of trees in a row or block, rather than replacing every vine or tree in that row or block. For example, an orchardist plants...
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a new block of apple trees. Of the 50 trees planted, six die due to wind damage. The cost of replacing those six trees can be claimed as a current year deduction under the general deductibility provisions. There is no need to adjust the tree account to which the cost of the whole planting had been capitalised. In summary, the replacement of vines and trees is treated as follows:

(a) New plantings — capital;
(b) Replacement with new varieties — capital;
(c) Regrafting to existing trees — capital;
(d) Replanting of blocks — capital;
(e) Single vine or tree replacements — revenue.

(2) Write off of vines and trees

Section DO 4(4) permits the write off of the unexpired book value of vines or trees that have been replaced and completely removed. The replacement of a variety of vine or tree by cutting back and regrafting to the existing rootstock does not qualify for a write off. This is because the vine or tree has not ceased to exist or ceased to be used for producing income. The rootstock, once regrafted with new budwood, will still be producing income sometime in the future. Further, the write off does not apply to vines or trees that ceased to exist or ceased to be used for producing income before 16 December 1991.

430.155 Crops other than listed horticultural plants

Asparagus plants and small berryfruit-producing plants (eg raspberries and strawberries), are “listed horticultural plants” [see 430.135]. Crops which are not “listed horticultural plants” should be treated for tax purposes as follows:

(a) For plants with a life span longer than that of annuals, the initial cost and the cost of planting is capitalised;
(b) Any subsequent replanting is regarded as replacement and deductible in the year incurred;
(c) The planting of vines or trees on the land (but not timber trees) may be depreciated as expenditure on land improvements; and
(d) The replacement crop and the cost of planting crops, as part of a crop rotation programme, are deductible in the year of replacement provided there is no increase in the acreage under cultivation.

430.160 Tobacco growers

The valuation of the stock on hand at balance date of a tobacco grower must be based on cost or market value. “Cost” is determined as expenditure incurred by each grower for the crop grown and harvested but not sold at balance date. Valuations of stock on hand based on a standard value are not acceptable. The most favourable balance date for tobacco growers, if undue fluctuation of stock valuations is to be avoided, is 31 July.

430.165 Flower growers

The cost of lily bulbs and tubers purchased by a flower-farming business is deductible because:

(a) Bulbs and tubers have to be continually replenished;
(b) Bulbs and tubers have a limited lifetime, and therefore do not create an enduring benefit; and
(c) Expenditure on bulbs and tubers cannot be regarded as “once and for all” because most die or become unusable within a year.


430.170 Deduction for food, stores, and lodgings supplied to employees

The cost of stores and rations supplied to employees is deductible where an accurate record is kept of the cost of rations supplied. If the stores and rations are bought with those for the farmer and the farmer’s family, apportionment of the total cost needs to be made to find the amount that can be claimed. An apportionment on a “per person per week” basis is accepted provided an accurate record of the total cost of stores and rations is kept.
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is kept, and items of personal expenditure not normally shared with employees are excluded. If the detailed record gives a reasonable result, the “per person” basis established in one year could be used in future years. However, in some circumstances the CIR may ask that full records be kept.

The farmer may claim depreciation and outgoings, such as repairs and maintenance, on a house supplied free to an employee.

430.175 Assessability of allowances or benefits in the hands of employees

The value of benefits provided to employees by way of the provision of board or lodging or the use of a house or quarters is taxable to the employee. Cash allowances paid in lieu of those benefits are also included. The value of these benefits or the cash allowances must be added to the monetary wages, and tax is deducted on the basis of the gross amount, according to the appropriate tax table and the employee’s tax code. To overcome the difficulty in valuing the benefits, the CIR accepts that a fair indication of the real value is the amount of the cash allowance that must be paid in terms of the relevant contract of employment if free board and lodging is not provided [see TES 6 (July 2003) 78].

The rental value of a free house supplied to an employee should be realistic and fair and reasonable bearing in mind the value of the house and its remoteness from town. One basis which is often used is to consider the rentals of comparable houses in the nearest centre and then reduce that figure for remoteness.

430.180 Working partners and shareholder-employee positions contrasted

A working partner in a partnership is in a different legal position from a shareholder-employee in a close company. In the latter case, the shareholder is an employee of the company whereas, in the case of the partnership, the partner is not an employee but is a part proprietor. If a partnership incurs expenditure on personal living costs of a partner it is not deductible by the partnership and is added to the partner’s share of the partnership profits. The full value of items such as stores, meat, fuel, three-quarters of private power, and the private portion of partnership car expenses which have been incurred by the partnership, but not depreciation and normal maintenance of the dwelling, are treated as private expenditure of the partner benefiting from the expense. Depreciation and repairs and maintenance on the dwelling occupied by the partner are treated in a different way. As in the case of a sole farmer, only one-quarter of depreciation, repairs and maintenance, and domestic power is deductible. The balance of depreciation and repairs and maintenance is not allowed as a deduction.

430.185 Sharemilkers and contract milkers

All sharemilkers are classed as taxpayers in business on their own account. No tax deductions are to be made from their shares of dairy cheques or from any other payments to them including any wages paid by the farmer with whom the sharemilker has entered into a sharemilking agreement. The sharemilker is required to furnish returns and make provisional tax payments in the same way as other self-employed persons. Income derived by a sharemilker is assessable. A deduction is allowable for shed and other farm expenses which are required under the contract.

Where a sharemilker also receives wages from the farmer with whom the sharemilker has a sharemilking agreement, the wages may be paid by the farmer without tax deductions. The wages then form part of the income of the sharemilker from sharemilking and are treated as provisional income for taxation purposes. This applies only to wages received by the sharemilker from the farmer and not to wages received from other employers.

Where a sharemilker owns the herd, or an owner of land is operating under a sharemilking agreement, the rental value of a house provided for either party under the sharemilking agreement or arrangement is not subject to taxation.

Whether or not a sharemilking agreement creates a partnership when made by the owner of a farm with a sharemilker couple is a matter to be decided on the terms of the agreement. Where the sharemilkers are merely contractors who contract to do certain work in return for payment by way of a share in the farming profits, they are not partners carrying on the business of farming.
Contract milkers are employees for tax purposes meaning that employers need to account for PAYE deductions and ACC levies for all payments made. Any contract milker who considers that this ruling should not apply to any particular contract can have the matter considered on an individual basis.

**430.190 Shearers, shed hands, and shearing contractors [s RD 8, sch 4]**

A farmer’s responsibility for PAYE tax deductions depends on the basis of the shearer’s engagement. If the shearing is undertaken by a shearing contractor who in turn employs the shearers, or the shearer is an independent self-employed person, payments made are schedular payments. In this case, the farmer is required to deduct tax at a flat rate of 15 per cent from the contract moneys payable to the contractor, but is not concerned with deductions which the contractor personally is obliged to make from payments to the contractor’s own shearers. If the shearing contractor produces an IR331 certificate of exemption issued by the CIR, no tax deduction at all is to be made from the payment to the contractor. The shearing contractor then accounts to the CIR for the tax deductions made from the shearers’ wages.

Farmers who employ shearers directly as employees must make tax deductions from the payments made to each individual shearer. If an employee has not provided their employer with an employee declaration form showing their tax code, tax deductions must be made at the “no declaration” rate of 45 per cent.

Shearing contractors and self-employed shearers are usually carrying on a business and are entitled to deduct expenditure necessarily incurred in carrying on the business. Self-employed shearers may deduct the cost incurred in the purchase of new and replacement combs and cutters. A handpiece is an asset which is required to be capitalised and depreciated unless it costs not more than $500 and meets the other requirements for the low-value asset write off [see 250.50].

The travelling allowance and hand piece allowance derived by employees are non-taxable.

Allowances paid to shearers and shed hands to cover the cost of combs, cutters and other equipment are exempt, provided that the amount is no more than is reasonable.

All other payments of allowances plus the value of free meals and board are taxable and should be added to wages.

**430.195 Shepherds, drovers, and musterers allowances**

Permanent shepherds, musterers, and general farm employees who are required to supply their own working dogs, horses, and saddlery, are entitled to have part of their salary treated as a non-taxable allowance. The amount treated as non-taxable must be no more than is reasonable.

**430.200 Employee allowances in remote areas to meet boarding school costs for children**

These allowances are deductible for the farmer and are not assessable to the employee provided that:

(a) the allowance is for children of farm employees living in remote areas;

(b) a boarding allowance is paid by the Ministry of Education for the child or children concerned; and

(c) the employer actually pays a boarding allowance in addition to the allowance paid by the Ministry of Education.

The tax-free limit is the smallest of:

(a) the allowance actually paid;

(b) the extent to which it is used by the employee to pay the child’s or children’s board; or

(c) $150 per child with a maximum of $450, when there are three or more children.

The arrangement does not apply when there is a close relationship between the employer and employee (eg when the farmer’s grandchildren are involved).
Chapter 440

Farmers’ Income Equalisation Scheme

440.05 Overview [ss EH 1, EH 2]

Income equalisation schemes provide a mechanism by which taxpayers engaged in certain industries can smooth the level of their taxable income. The smoothing is achieved by the fact that deposits of money into the scheme are tax-deductible while refunds from the scheme are taxable. Eligible taxpayers can deposit money into the schemes in years in which their taxable incomes and marginal tax rates are high and withdraw it in years in which their incomes and marginal tax rates are lower.

There are three income equalisation schemes in operation:

(a) **Main income equalisation scheme**: which is available to farmers, fishers and foresters;

(b) **Adverse event income equalisation scheme**: which is available to farmers who sell livestock but who do not replace the livestock because of a self-assessed adverse event; and

(c) **Thinning operations income equalisation scheme**: which is available to forestry companies in the years in which they derive income from thinning operations.

Deposits are made by remitting the money to the CIR. The funds deposited are then held in a special Crown bank account called the “Income Equalisation Reserve Account” which is operated under the Public Finance Act 1989.

440.10 Entitlement to use the scheme [ss EH 3, EH 34]

Deposits to the main income equalisation scheme can be made by:

(a) Any taxpayer carrying on a farming or agricultural business on any land in New Zealand;

(b) Any taxpayer carrying on a fishing business; or

(c) Any taxpayer (other than a company, a public authority, a Maori authority, or an unincorporated body) who derives gross income from forestry.

The term “farming or agricultural business” is restrictive and various types of business do not qualify [see 430 FARMERS]. Agricultural contracting income is not income from a farming or agricultural business, and consequently is not eligible for the scheme. However, where a taxpayer combines the business of farming with a business as an agricultural contractor, the schemes are available in respect of the income from farming.
“Fishing” includes rock oyster farming, mussel farming, and freshwater fish farming under a licence issued under the Freshwater Fish Farming Regulations 1983.

“Income from forestry” means income from the sale of standing or cut or fallen timber in its natural state grown on land owned by a taxpayer in New Zealand (other than as licensee) or from rights to cut or remove such timber. It also includes “PFSI forestry income”. PFSI forestry income is income from a PFSI forestry business which relates to a forest sink covenant entered into by the person. The income referred to is income which is derived from the receipt of emissions units under the covenant or from entering into a transaction in relation to such a unit.

440.15 Deposits [ss DQ 1, EH 4, EH 5, EH 7, EH 8, EH 35]

For a deposit to be deductible in calculating net income for a tax year it must be made either:

(a) During the accounting year; or

(b) Within the “specified period” for the immediately preceding accounting year, in which case a written election must accompany the deposit.

“Accounting year” means the year to the person’s annual balance date.

Deposits made are deductible. The deduction is taken in the tax year for which the deposit is made. The amount of the deduction is the lesser of the total deposits made for that tax year and the person’s “main maximum deposit” for that tax year.

The “specified period” is the shorter of a period ending:

(a) Six months after balance date; and

(b) One month after the due date for furnishing the return of income.

The CIR has a discretion to accept a deposit for an income year where the request is made outside the specified period. The CIR’s standard practice in this regard is set out in standard practice statement SPS 05/09 [see TIB vol 17:8 (October 2005) at 7-14].

“Main maximum deposit” means the “maximum deposit” that can be made to the person’s main income equalisation account.

“Maximum deposit” means:

(a) Where the taxpayer derives income from forestry, an amount equal to the income from forestry derived in that tax year;

(b) Where the taxpayer derives any income from the business of fishing, an amount equal to the income derived in that tax year from that business; and

(c) Where any taxpayer is engaged in any farming or agricultural business on any land in New Zealand, an amount equal to the income derived from that business in that tax year. This amount is reduced by any amount deposited by the taxpayer for that accounting year in the taxpayer’s adverse event income equalisation reserve account.

The Governor-General may by Order in Council declare that, for any tax year or years, the maximum deposit shall be an amount calculated in the manner specified in the Order in Council or shall be an unlimited amount.

Once a voluntary refund has been made for a tax year, no further deposits may be made for that same tax year, unless the CIR is satisfied that, before the subsequent deposit is made, the refund has been wholly expended on development or expansion of the business. However, using the specified period option, where a voluntary refund is made during the year, it is possible to make deposits in that same tax year for another tax year.

The CIR is required to maintain a separate main income equalisation account in the name of each person making a deposit. This account is able to be used only for the deposits and interest thereon.

Deposits are required to be in minimum amounts of $200 or such lesser amount which brings the aggregate deposits for the year to the allowable maximum.
Where aggregate deposits for a tax year exceed the allowable maximum, The CIR is required to refund the excess as soon as it is practicable. The provisions of the scheme do not apply to any excess deposits [see TES 6 (July 2003) 84].

Amounts entered in a taxpayer’s account are unable to be assigned or charged or pass by operation of law to any other person. Neither are they able to be assets for payment of debts (except by reason of bankruptcy) or for the payment of the debts and liabilities of the taxpayer’s estate, so long as they remain in the reserve account.

440.20 Interest payable on deposits [s EH 6]

Interest at the rate of three per cent per annum is payable on deposits, computed with daily rests from the date of acknowledgement of the receipt of a deposit until refunded; but no interest is payable on any deposit withdrawn within 12 months.

The interest accrues until 31 March in each year (or until the date of refund, if that is earlier) and is then added to and forms part of the deposit. The interest thus becomes assessable as business income, or income from forestry as the case may be, in the income year in which the refund is assessable: TRA Case 77 (1982) 5 TRNZ 705. The interest forms part of the deposit for the purposes of the allocation of the deposit to a year other than the year of payment and the interest goes with the principal or the deposit of that year accordingly.

440.25 Automatic refunds [ss EH 10, EH 11, EH 28]

The maximum time for which a deposit may remain in a person’s account is five years following the end of the tax year for which the deposit was made. Any deposit remaining after the five-year deadline is automatically refunded by the CIR unless the amount is less than $200.

440.30 Voluntary refunds [ss EH 12, EH 13, EH 14, EH 15, EH 16, CB 27]

Refund applications must be made in writing. No refund is able to be made of amounts less than the lesser of $200 and the balance of the account. The minimum period for which a deposit must be held in a person’s account varies with the circumstances surrounding the person’s application for a withdrawal.

(1) Twelve-month minimum period

The CIR is required to refund the amount applied for provided that it has remained in the account for not less than one year. The refund generally will be taxable in the tax year in which application for the refund was made. However, where the application is made during the “specified period”, the taxpayer is able to choose that the refund be taxable in the prior tax year being the tax year to which the specified period relates.

The CIR has a discretion to allow a refund for an income year where the request is made outside the specified period. The CIR’s standard practice in this regard is set out in standard practice statement SPS 05/09 [see TIB vol 17:8 (October 2005) at 7-14].

(2) Six-month minimum period

A refund is able be made of any amounts deposited for six months or more where the CIR is satisfied that the refund is required for either or both of the following purposes:

(a) For immediate development or repair work; or

(b) For immediate purchase of livestock (other than to replace livestock sold or lost as a result of a self-assessed adverse event).

(3) No minimum period

There is no minimum period for which funds must remain on deposit before a refund can be made where the CIR is satisfied that the refunded amount will be used for any one or more of the following purposes:

(a) Replace livestock sold or lost as a result of a self-assessed adverse event;

(b) Avoid serious hardship; or

(c) Any other purpose for which the CIR determines a refund shall be made.
440.35 Refund on retirement [ss EH 17, EH 18, EH 27]
Where the CIR is satisfied that the taxpayer (not being a company or a trustee) has retired from farming or fishing as the case may be, the following provisions apply:
(a) Any balance in the account is refundable automatically; and
(b) It is assessable as income derived during the year in which the taxpayer retires, unless and to the extent to which the deposit was made for an earlier tax year and the taxpayer elects in writing to have all or part of that deposit assessed as income for that earlier year. Any such election must be made within the time during which the taxpayer is required to furnish a return of income for the year of retirement, or within such extended period as the CIR may allow. Any necessary amendments to earlier assessments may be made notwithstanding the normal four-year time limit.

440.40 Refund on death [ss EH 12, EH 19, EH 20, EH 21, EH 22]
When a depositor dies, any balance remaining in the reserve account is generally automatically refundable. It is assessable as income in the period to the date of death unless the trustee elects in writing to either:
(a) Have the amount assessed wholly or in part as income derived by the deceased during the lifetime in the earlier years in which the relevant deposits were deducted. In this case, the provision is the same as on retirement; or
(b) Spread the amount, or any part of it, forward to any of the three years after death but subject to the maximum five year deposit term.
The trustees may only make an election under (b) if they have not made an election under (a). If this second alternative is adopted, the trustee must state in the application the respective amounts of deposits to allocate to each or any of those succeeding years, and the funds so allocated must remain in the account until the time specified in the application and are deemed to be trustee income derived at the time specified in the election. If either of the alternatives is elected, the trustee must make written application within the time by which it is required to furnish a return of income derived by deceased to the date of death, or such further time the CIR in its discretion may allow.
In each case, any amendments to assessments issued for the earlier years may be made notwithstanding the normal time bar limitation for re-opening assessments.

440.45 Refund on bankruptcy [ss EH 12, EH 23, EH 24]
Where any taxpayer is adjudicated a bankrupt, all amounts standing to the credit of the bankrupt’s income equalisation account on the date on which the CIR receives notice of the adjudication are refundable to the Official Assignee. This includes any amount held which exceeds the maximum deposit. The refunded amounts are assessable as income derived during the period to date of adjudication.

440.50 Refund on liquidation of company [ss EH 12, EH 25, EH 26]
On the liquidation of a company (whether voluntarily or otherwise) all amounts remaining in the company’s reserve account on the date on which the CIR receives notice of the liquidation are to be refunded. The refund is assessable as income derived during the period to date of liquidation.

440.55 Tax credit [ss EH 30, EH 31, EH 32, EH 33]
Refunds from a taxpayer’s account are deemed to have been made in the order in which the deposits were made.
A tax credit is available to ensure that a refund does not attract more tax than would have been paid if the deposit had not been made. This does not apply to any refund which is assessed in the same year as the deposit was made. More than one refund may be assessed in a particular year, and this may comprise several deposits or parts of deposits. The total “extra tax” attributable to refunds assessed in a year is aggregated and compared with the “tax saving” attributable to the individual deposits or part deposits in the year deducted. If additional
tax is payable, a rebate equal to the additional tax is allowed in the tax year in which the refund is taxed. For the purpose of calculating the rebate, the tax saving for any particular deposit is a proportionate amount based on the ratio of the deposit being refunded to the total deposits deducted for a particular accounting year.

“Extra tax” means the amount by which the income tax payable on the income exceeds the amount that would have been payable had those refunds not been included.

“Tax saving” means the amount by which the income tax payable on the income is less than the amount that would have been payable had those deposits not been deducted.

440.60 Adverse event income equalisation scheme [ss DQ 2, EH 37, EH 38, EH 39, EH 40, EH 41, EH 42, EH 43, EH 44, EH 45, EH 46, EH 47, EH 48, EH 49, EH 50, EH 51, EH 52, EH 53, EH 54, EH 55, EH 56, EH 57, EH 58, EH 59, EH 60, EH 61, EH 62]

The adverse event income equalisation scheme enables farmers to spread, across future income years, the gross amount of income arising from forced sales of livestock.

(1) The scheme

A “self-assessed adverse event” means a fire, flood, drought, or other natural event, or sickness or disease among the livestock that materially affects the taxpayer’s farming or agricultural business and for which the taxpayer has made and furnished to the CIR a statutory declaration describing the event and specifying how the taxpayer’s business is affected.

An “adverse event income equalisation account” is kept in the taxpayer’s name by the CIR under rules distinguishing it from any “main income equalisation account” which operates under the general rules.

The scheme is available to any taxpayer who is engaged in a farming or agricultural business on land in New Zealand and who sells livestock and does not replace it in the same tax year because of a “self-assessed adverse event”.

No amounts in a taxpayer’s adverse event income equalisation account may be assigned or charged, or pass to any person by operation of law (except through the bankruptcy or liquidation of the taxpayer), or be assets for the payment of the taxpayer’s debts or liabilities or of the debts or liabilities of the taxpayer’s estate (in the event of the taxpayer’s death), at any time before they have been duly refunded.

(2) Deposits

Taxpayers are allowed a deduction for the amount of any qualifying deposits made for a tax year.

The maximum deposit for a taxpayer is the total of the net income arising as a result of the event. The amount calculated on the basis that the cost of all livestock sold due to the effect of that adverse event is either:

(a) Determined using the immediately preceding accounting year’s closing value for the class or classes of livestock in which, had that livestock not been sold, it would have been included at the end of the accounting year in which the livestock was sold; or

(b) If no relevant livestock was on hand at the end of the immediately preceding accounting year, an amount calculated in accordance with the following formula:

\[
\frac{\text{number at start} \times \text{value} + \text{number bought} \times \text{price}}{\text{number at start} + \text{number bought}}
\]

Where:

“Number at start” is the number of livestock of the class sold which was on hand at the beginning of the tax year of sale.

“Value” is the opening value of livestock of the class sold which was on hand at the beginning of the tax year of sale. This is determined without applying s EC 16(2) (valuation under herd scheme).
“Number bought” is the number of livestock of the class sold which was purchased in the accounting year of sale before the sale of that livestock.

“Price” is the average purchase price of the number bought.

**Example 1:**
A farmer using the herd scheme for all classes of sheep is affected by a drought during the 20X1 income year. The farmer is forced to sell 400 rising five year old ewes in December 20X0. The maximum deposit is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale price of 400 ewes at $43 per head</td>
<td>$17,200</td>
</tr>
<tr>
<td>Book value of ewes at $40 per head (closing book value of rising 5 year and older ewes for the 20X0 year herd values)</td>
<td>$16,000</td>
</tr>
<tr>
<td>Maximum deposit</td>
<td>$1,200</td>
</tr>
</tbody>
</table>

**Example 2:**
A farmer uses the national standard cost scheme for all sheep. A drought forces the reduction in capital livestock by 400 mixed aged ewes. These animals were in the mature inventory grouping under the average cost inventory system. The opening value of the mature inventory grouping during the year of forced sale was $23 per head. The maximum deposit is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale price of 400 ewes at $40 per head</td>
<td>$16,000</td>
</tr>
<tr>
<td>Opening book value ($23 per head)</td>
<td>$9,400</td>
</tr>
<tr>
<td>Maximum deposit</td>
<td>$7,800</td>
</tr>
</tbody>
</table>

The minimum deposit is $200 or the amount that increases the aggregate amount of all payments by way of deposits previously made for that accounting year to the taxpayer’s maximum deposit for that year, whichever is the lesser.

Deposits to the adverse event income equalisation account for a tax year may be made during the accounting year or during the month immediately following the end of that accounting year.

**(3) Interest**
Interest, at the rate set by the Governor-General by Order in Council, is payable on deposits. The rate is intended to reflect market rates. The interest is computed with daily rests from the date of receipt until the date the deposit is refunded or, as the case may be, credited to the taxpayer’s main income equalisation account. All interest accrues until 31 March, and is then added to, and forms part of, the deposit.

**(4) Automatic transfer**
Where any deposit remains in the taxpayer’s adverse event income equalisation account 12 months after the day on which that amount was deposited, the amount plus any interest is transferred to the taxpayer’s main income equalisation account. For the purposes of computing interest payable, it is treated as having been deposited in the main income equalisation account on the day on which it was transferred. For all other purposes, it is treated as having been deposited in the taxpayer’s main income equalisation account on the day on which it was deposited in the adverse event income equalisation account. While these transfers increase the balance in the taxpayer’s main income equalisation account, they do not, of themselves, give rise to a tax deduction.

**(5) Refunds**
Refunds are income derived in the tax year in which the application for the refund is received by the CIR. The provisions for refunds on retirement, death, bankruptcy, or liquidation from the main income equalisation account also apply to the adverse event income equalisation account. Every refund made from the taxpayer’s adverse event income equalisation account must be in the order in which the deposits were made by the taxpayer. No refund made to a taxpayer can be less than $200 or the balance in that adverse event income equalisation account, whichever is the lesser.
440.65  **Thinning operations income equalisation scheme** [ss DQ 3, EH 63, EH 65, EH 66, EH 67, EH 68, EH 69, EH 70, EH 71, EH 72, EH 73, EH 74, EH 75, EH 76, EH 77, EH 78, EH 79]

The thinning operations income equalisation scheme allows companies that carry on a forestry business in New Zealand to spread across future tax years the income from thinning operations.

(1) **The scheme**

The scheme is available only to foresters who are companies.

For the purposes of the scheme, “forestry business” includes permanent forest sink initiative forests established under the emissions trading scheme.

The term “thinning operations” is defined as operations in which some trees in an immature stand of trees are felled for the purpose of improving the growth and form of the remaining trees and not for the purpose of permanently breaking the canopy.

Where a company carries on both farming and forestry operations in New Zealand, separate reserve accounts are required to be kept for deposits in the main income equalisation account and deposits of thinning income.

(2) **Deposits**

The whole of the proceeds from thinning operations derived during a tax year may be deposited in the account.

When calculating the amount, stock on hand at the beginning and end of the year, any provision of the Act that spreads income or deductions, and the provisions of the various income equalisation schemes are ignored.

The minimum deposit is the lesser of $200 and the difference between deposits already made for the tax year and the person’s “thinning operations maximum deposit”.

The deposits are allowable as a deduction in the year for which they are made (ie forestry companies have the option available to farmers of allocating the deduction to either the accounting year in which the deposit is made, or the immediately preceding accounting year covered by the “specified period”).

The “specified period” is the shorter of six months after balance date and one month after the due date for furnishing the return of income. The CIR can extend the period on a case by case or class by class basis. The CIR has a discretion to accept a deposit for an income year where the request is made outside the specified period. The CIR’s standard practice in this regard is set out in standard practice statement SPS 05/09 [see TIB vol 17:8 (October 2005) at 7-14].

Where the person has received a voluntary refund or a development or recovery refund for a tax year, a deposit may be made for that tax year only where the CIR is satisfied that the refund has been used to expand or develop the person’s business.

(3) **Interest**

Interest at the rate of three per cent is computed with daily rests from the date of acknowledgement of deposit until the earlier of 31 March in each year and the date of refund. Accrued interest is added to the deposit. No interest is payable where the deposit is refunded within one year of deposit.

(4) **Refunds**

A request for the refund of amounts that have been in the person’s thinning operations income equalisation account for at least one year can be made at any time during a tax year or during the specified period following the end of a tax year.

A request for the refund of amounts that have been in the person’s thinning operations income equalisation account for at least six months can be made if the CIR is satisfied that the amount will be used for planned development or maintenance work for the forestry business.

There is no minimum period for which funds must remain in the account where the refund is to be used to avoid serious hardship or for another purpose that the CIR determines should give rise to the refund.
In each case, the refund is taxable in the year in which the refund application is made. However, where the application is made during the “specified period”, the person can choose for the amount to be taxable in the year to which the specified period relates. The CIR has a discretion to approve a refund for an income year where the request is made outside the specified period. The CIR’s standard practice in this regard is set out in standard practice statement SPS 05/09 [see TIB vol 17:8 (October 2005) at 7-14].

Where the taxpayer company is put into liquidation, the CIR must refund the balance in the account regardless of the length of time for which the amount has been in the account. The refund is income derived by the company immediately prior to the commencement of the liquidation.

No refund can be given of an amount that is less than the smaller of $200 or the balance in the account.

(5) Tax credit

The provisions of the main income equalisation scheme that provide for a tax credit to ensure that a refund does not give rise to more income tax than was saved when the deposit was made apply equally to the thinning operations income equalisation scheme [see 440.55].
Chapter 460
Film Industry

460.10 Income from films [s CC 10]
When a person has a right or an interest in a film, a print of the film, publicity material for the film, or any other tangible asset relating to the film, the following amounts are income:

(a) An amount received or receivable for:
   (i) The use of, or right to use, the film or a right or interest in a right in the film;
   (ii) The granting of a licence for a future right in the film;
   (iii) The disposal of some or all of a right or interest in a right in the film;
   (iv) The assignment of a right or an interest in a right;
   (v) The assignment of a right to derive income from the use of a right or interest; and

(b) The amount derived from the rental, sale, use or other exploitation of the film.

The “right or interest” referred to above means a current, future or contingent right or interest of any of the following kinds:

(a) Copyright in a film;
(b) A licence relating to the copyright;
(c) An equitable right in the copyright;
(d) An equitable right in a licence relating to the copyright;
(e) Any other right existing in or attaching to the film;
(f) A right to income, or a share of income, from the rental, sale, use or other exploitation of the film.

Section CC 10 is overridden by ss CV 17 and YD 7 [see 460.55].

460.12 Tax treatment of government film funding [ss CX 47, CX 48C, DF 1, DF 5]
Government funding for film and television productions includes:

(a) Screen production incentive fund (SPIF): Introduced on 1 July 2008, this fund provides a grant to a production company of 40 per cent (for feature films) or 20 per cent (for television and other screen productions) of the qualifying New Zealand expenditure, provided certain criteria are met.
(b) **Additional funding (co-funding) by government agencies**: Government agencies such as the New Zealand Film Commission, NZ On Air, the New Zealand Film Production Fund Trust and Te Māngai Pāho are able to provide additional funding for productions that receive the SPIF grant.

For income tax purposes, LBSPGs and SPIF grants are collectively known as “government screen production payments” (GSPP). The grant or incentive must be approved by the New Zealand Film Commission and paid to a company that is resident in New Zealand or has a permanent establishment in New Zealand. GSPPs do not include funding payments (ie co-funding).

Prior to 1 October 2009, funding was also available under the large budget screen production grant scheme. See *Staples Tax Guide 2011*, 460.15.

From 1 October 2009, the income tax treatment of all three types of payments are similar.

GSPP grants are excluded income under s CX 47. The recipient of a GSPP grant is denied a deduction for the expenditure (including expenditure on depreciation property) for which the grant was provided, to the extent of the amount of the grant [s DF 1]. Effectively, the film company’s deductions are reduced by the amount of the grant.

Funding payments are excluded income under s CX 48C. Funding payments are payments, which are not grants, subsidies, or grant-related suspensory loans, made by a public authority to a company in addition to a GSPP. The recipient of a funding payment is denied a deduction for the expenditure for which the funding payment was provided, to the extent of the amount of the payment [s DF 5]. Effectively, the film company’s deductions are reduced by the amount of the funding payment. The recipient of a funding payment is allowed a deduction for any repayment of the funding payment they make, to the extent that the repayment is part of the arrangement with the funding provider.

A deduction is available for film production expenditure under s DS 2, and the deduction is allocated to an income year under ss EJ 4, EJ 5, EJ 7 or EJ 8 [see 460.20].

The taxation of government grants in general is explained at 610.05.

### 460.17 Disclosure of information by Inland Revenue [TAA, s 85F]

In order to assist the New Zealand Film Commission (NZFC) to obtain the information needed to enable it to determine the entitlement of a company to a GSPP, the CIR is authorised to provide the NZFC with the following information:

(a) Particulars relating to the amount of expenditure incurred (in New Zealand or elsewhere) in relation to a project that is the subject of an application for a GSPP;

(b) The CIR’s opinion as to the accuracy of any information provided by an applicant in relation to an application for a GSPP.

If any of the information required by the NZFC is not held by the CIR, the CIR is authorised to use its information gathering power’s under Part 3 of the TAA to obtain that information.

### 460.20 Deductions for film production expenditure [ss DS 2, DS 2B, EJ 6, EJ 7, EJ 8]

A comprehensive tax regime applying specifically to the film industry was introduced with effect from the 1982-1983 income year and modified for films completed on or after 16 December 1983. Film production expenditure (as defined) is deductible only under ss DS 2 and DS 2B.

The deductibility of costs of production or acquisition of films excluded from these provisions must be determined under the general permission and general limitations. Section DS 2 contains the principal film production expenditure rules. A person is allowed a deduction for film production expenditure if:

(a) The film is completed; and

(b) The person has a “film right” [s YA 1] in the film, before, during or after its completion.

“Film production expenditure” is:

(a) An amount of expenditure or loss incurred in producing a film;
An amount of depreciation loss on property used in producing the film; or
An amount of depreciation loss arising from a disposal of property used in producing the film [s YA 1].

“Film production expenditure” specifically excludes:
Expenditure incurred in acquiring depreciable property;
Costs of acquiring a film right after the film is completed; or
Film marketing and selling costs.

“Large budget film grant” means a payment that:
Is in the nature of a large budget screen production grant or post-production digital and visual effects grant;
Is made in relation to a film or television production; and
Is authorised by the New Zealand Film Commission in relation to a company that is resident or has a permanent establishment in New Zealand.

Film production expenditure includes such post-production costs as:
Taking the film from the double head fine cut stage to the stage it is ready for distribution to cinemas;
Converting the film from 18 mm to 35 mm gauge; and
Adapting the film for overseas exhibition, such as dubbing or cutting [see PIB 120 (March 1983)].

Film production expenditure and interest incurred in producing a film that is incurred before a film is completed, extends to film production expenditure reimbursed by a person (ie when a person reimburses another’s film production expenditure, the reimbursement takes on the same nature as the expenses the amount is reimbursing).

The deduction available under s DS 2 is allocated under:
Section EJ 4 (acquiring film rights in feature films) or s EJ 5 (acquiring film rights in other films), if a large budget film grant has been made for the film; or
Section EJ 7 (New Zealand films) or s EJ 8 (other films), if a large budget film grant has not been made for the film.

A deduction is not available for film production expenditure if:
The film is produced mainly for broadcast in New Zealand by a person who operates a television station, television network or cable television system;
The film is intended to be shown as an advertisement; or
Section DS 2B applies to the film production expenditure (see below).

The amount of deduction available under s DS 2 may be reduced, or the timing of the deduction may be delayed, under ss GB 17, GB 18 or GB 19 [see 460.50].

(1) Films intended for sale [s DS 2B]
A deduction is allowed for film production expenditure or expenditure incurred in acquiring a film right if, at the time the expenditure is incurred, the intention is to dispose of the film or film right. The deduction so allowed must be allocated under s EA 2 [see 1140.80]. The right to the deduction overrides the capital limitation, but the general permission must still be satisfied and the other general limitations apply.

(2) New Zealand films [s EJ 7]
A deduction for film production expenditure is allocated under s EJ 7 if the film has significant New Zealand content and a large budget film grant has not been made for the film. To verify that the film has significant New Zealand content, the film must have a final certificate issued under s EJ 6.
Film production expenditure is allocated to the later of:
The income year in which the film is completed; or
(b) The income year in which the expenditure is incurred. Thus, the deduction for film production expenditure incurred before the film is completed is deferred until the income year in which the film is completed. Expenditure incurred after the film is completed is allocated to the income year in which it is incurred.

A film is “completed” when it has reached the stage of production at which the film has been completely edited, shot by shot, to its final length, or an equivalent production stage [s YA 1].

(3) Films that are not New Zealand films [s EJ 8]

A deduction for film production expenditure is allocated under s EJ 8 if the film does not have significant New Zealand content and large budget film grant has not been made for the film. The film production expenditure is deductible over a two-year period commencing with the year in which the film is completed.

Example:

A film (not a New Zealand film), is completed in 20X2. Deductions available to the film owner are as follows (assuming a 31 March balance date):

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost of production</th>
<th>Cost of marketing</th>
<th>Deduction for year</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1</td>
<td>$1,200,000</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>20X2</td>
<td>$1,800,000</td>
<td>$100,000</td>
<td>$1,600,000</td>
</tr>
<tr>
<td>20X3</td>
<td>—</td>
<td>$200,000</td>
<td>$1,700,000</td>
</tr>
<tr>
<td>Total</td>
<td>$3,000,000</td>
<td>$300,000</td>
<td>$3,300,000</td>
</tr>
</tbody>
</table>

Note 1. Deduction 20X2:
- Cost of production (50% of $3,000,000) $1,500,000
- Marketing costs $100,000
  - Total $1,600,000

Note 2. Deduction 20X3:
- Cost of production (50% of $3,000,000) $1,500,000
- Marketing costs $200,000
  - Total $1,700,000

If film income derived in the income year is more than 50 per cent of the film production expenditure, the deduction may be increased to the lesser of the amount of film income and the total amount of the deductible film production expenditure. Film production expenditure incurred after the film is completed is deductible in the year incurred.

If a person disposes of a film right in the year the film is completed (such that they own no right in the film at year end), any remaining deduction for film production expenditure is deductible in that year.

In *DB Group Ltd v Commissioner of Inland Revenue* (1996) 17 NZTC 12,446 (HC), the High Court dealt with issues relating to the New Zealand-made film “The Navigator”. One issue was whether an amount paid by the taxpayer towards the production costs of the film, and in return for which the taxpayer became a part owner of the completed film, represented film production expenditure in terms of s EO 4(4) of the ITA 1994 [now s DS 2]. The Court held that the payment did come within the definition of “film production expenditure” in s OB 1 of the ITA 1994 and that therefore the favourable tax treatment allowed by s EO 4(4) of the ITA 1994 was available to the taxpayer.

460.25 Limitation on film expenditure deduction to amount at risk

[ss GB 45, GB 46, GB 47, GB 48]

Until the end of the 2003-2004 income year, s DK 1 of the ITA 1994 limited the deduction available to investors for film expenditure financed from limited recourse loans. This provision was anti-avoidance in nature and restricted deductible film expenditure to expenditure and depreciation not financed by a limited recourse loan. Film production expenditure financed by a limited recourse loan was not deductible until such time as the limited recourse loan was repaid.

From the 2004-2005 income year, the deferred deduction rule [see 240.215] applies to all such mass-marketed arrangements (ie not just those related to film expenditure). As a result, s DK 1 of the ITA 1994 was repealed.
from the 2004-2005 income year. However, it continues to apply to any taxpayer who has entered into an arrangement covered by the deferred deduction rule if, prior to the taxpayer’s 2004-2005 income year:

(a) The taxpayer could reasonably have anticipated that 10 or more persons would acquire an interest in the arrangement; or

(b) 70 per cent or more of the person’s deductions arise from ownership of fixed life intangible property or software.

460.30 Completed film acquisition cost [ss DS 1, EJ 4, EJ 5]

Under s DS 1, a person is allowed a deduction for expenditure that they incur in acquiring a film right, whether the film is completed before, at the time, or after the film right is acquired. Expenditure incurred in acquiring a film right is not deductible if the:

(a) Person operates a television station, a television network, or a cable television system, and the film right is acquired mainly to enable the film to be broadcast in New Zealand;

(b) Film is intended to be shown as an advertisement;

(c) Expenditure is film production expenditure; or

(d) Section DS 2B applies to the expenditure [see 460.20].

The timing of the deduction allowed for the acquisition of a film right is governed by s EJ 4 for feature films, and s EJ 5 for other films.

When the film right is a right in a “feature film” (35 mm films produced for the cinema of not less than 75 minutes duration) [s YA 1], s EJ 4 applies to determine the timing of the expenditure incurred in acquiring the film right that is deductible under s DS 1.

(1) Feature films [s EJ 4]

Expenditure incurred in acquiring a feature film is allocated under s EJ 4 if the expenditure is deductible under:

(a) Section DS 1; or

(b) Section DS 2 and a large budget film grant has been made for the film.

The cost of acquisition of the film right is spread over a 24-month period. The deduction is the lesser of the “remaining deduction” or the greater of the following amounts:

(a) The amount of the film income derived in the income year; or

(b) The amount apportioned using the formula:

\[(\text{completed months} / \text{non-completed months}) \times \text{deduction}\]

Where:

“Completed months” is the number of months (or part months) in the income year for which the film is completed.

“Non-completed months” is 24, reduced by the number of complete months in the period starting on the first day of the month in which the film is completed and ending on the last day of the income year for which the deduction is being sought.

“Deduction” is the amount of the deduction for expenditure incurred before the income year that has not been allocated to a previous income year.

(2) Non-feature films [s EJ 5]

Expenditure incurred in acquiring a film is allocated under s EJ 5 if the film is not a feature film and the expenditure is deductible under:

(a) Section DS 1; or

(b) Section DS 2 and a large budget film grant has been made for the film.
If the person has the film right at the end of an income year, the deduction that is allocated to the income year in which the film right is acquired or the film is completed (whichever is the later) is 50 per cent of the deduction or if film income derived in the income year was more than 50 per cent of the deduction, the lesser of the amount of film income and the total amount of the film acquisition expenditure.

If a person disposes of a film right during an income year, and does not own a film right in the film at the end of the year, the remaining deduction (the amount of deduction that has not been allocated to a previous income year) is deductible in that year.

Sections GB 17 and GB 18 contain some rules designed to ensure non-market transactions are not able to be used to manipulate the purchase price of a film right in non-arm’s-length transactions, or when the amount and timing of the expenditure have been deliberately altered to give a more favourable outcome than would have otherwise been the case [see 460.50].

**460.40 Clawback of deductions for film reimbursement schemes [ss DS 3, DS 4]**

Deductions otherwise available under ss DS 1 and DS 2 (or under the general permission if the expenditure is for a right in or in relation to a film) may be reduced retrospectively if a person enters into a scheme that essentially reimburses those costs.

Section DS 3 applies to expenses that are deductible under ss DS 1 and DS 2. Section DS 4 defines the scheme to which s DS 3 applies.

1. **Film reimbursement scheme [s DS 4]**

There are three requirements that must be satisfied.

The first requirement is that it is a scheme under which a person may incur expenditure for which they are allowed a deduction under ss DS 1 or DS 2 (or would be allowed a deduction but for s DS 3) or under the general permission if the expenditure is for a film right or a right to an amount that is dependent on or calculated by reference to income from the rental, sale, use, or other exploitation of a film.

The second requirement is that any one of the following applies to the arrangement:

(a) It enables the person or an associated person to dispose of property; or

(b) It gives a right to the person or an associated person to dispose of property; or

(c) It gives a right that creates an obligation for the person or an associated person that may be met by disposing of the property.

The third requirement is that it is a scheme under which some or all of the consideration for the property is not film income.

For the purposes of s DS 4, the following are associated persons:

(a) Persons associated under the provisions in Subpart YB that apply for the purposes of the whole Act (excluding the 1973, 1988, and 1990 version provisions); and

(b) A shareholder in a loss attributing qualifying company and the company.

2. **Claw back of deductions [s DS 3]**

When a person disposes of property under a film reimbursing scheme the total deductions allowed under ss DS 1 and DS 2 are reduced in accordance with the formula:

\[
\text{total deductions} - \text{total consideration}
\]

Where:

“Total deductions” is the total amount of deductions that have been allowed to the person under ss DS 1 and DS 2 (or would, but for the clawback rules in DS 3 be allowed).

“Total consideration” is the total consideration for the disposal of the property that the person derives that is not film income.
The deductions must be reduced in the order that they have been allowed as deductions. The total deductions must be reduced to an amount equal to the greater of zero and the amount resulting from the above formula. A taxpayer or an associated person affected by ss DS 3 and DS 4 must furnish a special return under s 44A of the TAA. The CIR is given the authority to amend any assessment affected, despite the statutory time bar on amending assessments.

(3) **Excluded expenditure**

Sections DS 3 and DS 4 do not apply to substantial expenditure ($1,000,000 minimum), that is incurred before 7 July 1999 on goods and services in relation to a qualifying film (ie a film which is a New Zealand Film or for which the Film Commission has issued a provisional certificate), if:

(a) The film is not completed before that date;
(b) The required notice is given to the CIR;
(c) The recipient of the payments for those rights is taxable in New Zealand or is resident in a country specified in Part A of sch 3;
(d) Total expenditure on the film is not greater than 140 per cent of the physical production costs; and
(e) The investor has a commercial expectation for profit;
(f) The person or an associated person disposes of property (eg shares) under the arrangement or under a right given by the arrangement; and
(g) All or some of the consideration for that property is not film income under s CC 10.

[see TIB vol 11:6 (July 1999) at 34-35 and TIB vol 11:9 (October 1999) at 3-4].

460.45 **Effect of prepayments rules**

The provisions for the deduction of film production and acquisition expenditure set out very precise rules for the timing of the expenditure deduction. The prepayments rules [s EA 3] require the unexpired portion of accrual expenditure to be included as income. However, the prepayments rules do not override or destroy any existing specific deduction provisions (such as film production expenditure), in the Act. Furthermore, film production and acquisition expenditure is by nature expenditure on capital account and, therefore, falls outside the definition of prepaid expenditure [see PIB 168 (January 1988)].

460.50 **Avoidance matters** [ss DB 58, EJ 9, GB 17, GB 18, GB 19]

(1) **Non-market transactions to acquire film rights [s GB 17]**

A person is required to reduce the deduction allowed to them under ss DS 1 or DS 2 to the market value of the film right (or goods or services), at the time of purchase, if the CIR considers that the person purchasing the film right (or goods or services) and the person from whom the film right (or goods or services) was acquired were not dealing with each other on arm’s-length terms, and as a result the person purchased the film right (or goods or services) for more than the market value. If the buyer acquires only a share in a film right, the reduction applies only to the part of the total market value of the film right that is attributable to that share.

(2) **Manipulation of arrangements to acquire film rights or incur film production expenditure [s GB 18]**

If the CIR considers that two persons have made arrangements so that ss DS 1, DS 2, EJ 4, EJ 5, EJ 7 or EJ 8 apply more favourably than they would have in the absence of those arrangements, the deduction allowed under s DS 1 or DS 2 is reduced to the amount that the CIR considers would have been allowed if the arrangements had not been made. In addition, the deductions allocated under ss EJ 4, EJ 5, EJ 7 or EJ 8 are allocated to the income year to which the CIR considers they should have been allocated in the absence of the arrangement.
(3) **Film production expenditure if payments postponed or contingent** [ss EJ 9, GB 19]

If payment for goods and services has been excessively deferred by agreement between the supplier of goods and services and the person incurring the film production expenditure, or if the liability for payment is contingent, then, for the purposes of ss DS 2, EJ 7 and EJ 8, a person is treated as incurring the expenditure at the time of payment.

**460.55 Non-resident film renters liability to tax** [ss CV 17, DW 3, YD 7]

Ten percent of the amount derived by a non-resident person from a source in New Zealand, from one or more of the following activities is income of the non-resident:

(a) Renting, exhibiting, or issuing a film, or making other arrangements for its exhibition;
(b) Selling or hiring film container, cinematographic or photographic materials, or equipment or accessories relating to a film;
(c) Selling or hiring advertising materials relating to a film.

No deductions can be claimed against this income [s DW 3]. Thus, the income is effectively taxed at three per cent being 10 per cent of the total amount derived, at a tax rate of 30 per cent (assuming the non-resident person is a company). If a double taxation agreement regards the payments as a royalty, the tax payable in New Zealand is unlikely to change as it will be lower than the treaty rate in any case. The balance of the income not taxed under these rules (ie the other 90 per cent) is treated as not having a source in New Zealand.

If a non-resident person is required under an agreement with another non-resident (person A) to pay person A a film rent, royalty or commission, or an amount that arises from an amount derived by the non-resident person from the activities described in (a) to (c) above, the amount paid is treated as not having a source in New Zealand. Sections CV 17 and YD 7 do not apply if the amounts derived by the non-resident from the above activities are an insignificant proportion of the total amounts derived by them from a business in New Zealand.

When the film renter incurs a loss from any other source in New Zealand the loss is not deductible from the film rental income under s IA 8, and any excess loss can be carried forward [see 940 LOSSES].

A discussion of the tax treatment of non-resident film renters is set out in TIB vol 7:2 (August 1995) at 24-27.

**460.60 Treatment of payments to film industry workers**

It is very common in the film industry to engage people on a contract basis, rather than as employees. Thus, depending on the nature of the services, the income will either be taxed as a schedular payment or subject to provisional tax.

The following is a summary of the tax treatment of various types of payment made to film industry workers:

(a) If the person receiving the payment is a resident and is not an employee of the person making the payment, and the payment is made for work done or services rendered in relation to the production of television, video or film productions or presentations (ie a schedular payment), the payer must deduct tax from the payment at the rate of 20 cents in the dollar [sch 4]. This applies when the work or services are of a type that is commonly involved in the on-set and off-set pre-production, production and post-production process. This rate is consistent with the rate applying to resident and non-resident entertainers, and is intended to simplify tax practices for film producers [see 1320 SCHEDULAR PAYMENTS and TIB vol 15:8 (August 2003) at 13].

(b) If the person receiving the payment is not an employee of the person making the payment, and the payment is one of the classes of schedular payment other than film production services (eg freelance journalists and writers), tax must be deducted from the payment at the rate specified in sch 4 [see 1320.40].

(c) If the person receiving the payment holds a special tax rate certificate, tax must be deducted at the rate specified on the certificate [see 1320.20].
(d) A daily living allowance of up to $60 per day paid to contractors (resident or non-resident) living away from home while working on films may be paid free of tax [see 460.65].

(e) If the payment is a contract payment to a non-resident contractor, tax must be deducted at the rate of 15 cents in the dollar [see 1320.20].

(f) If the payment is made to a resident or non-resident entertainer, tax must be deducted at 20 cents in the dollar [see 1000.50].

(g) If the person receiving the payment is not an employee of the person making the payment, and the payment is not one of the classes of payment listed in sch 4, there is no requirement to deduct tax from the payment [see 1320.40].

The difference between an employee and an independent contractor in the film industry was considered by the Supreme Court in Bryson v Three Foot Six Ltd [2005] 3 NZLR 721, (2005) 22 NZTC 19,242 (SC) [see 335.30].

When non-resident employees of offshore production companies are working on a film project and are personally present in New Zealand for no more than 92 days in the tax year, they will be exempt from New Zealand tax under s CW 19. This exemption does not extend to “public entertainers.” The 92 day term may be extended to 183 days under New Zealand’s double taxation agreements. Once the 92 day (or 183 day) period is exceeded, an individual will become liable for income tax in New Zealand. To avoid the deduction of PAYE in the interim, the non-resident employer may provide a bond to Inland Revenue under s RD 23.

The entertainers articles contained in New Zealand’s double tax agreements may apply. These provisions generally give the taxing rights to the country in which the performance or activities are exercised. However, this is only a general rule. For example, the United States-New Zealand treaty provides that a theatre, motion picture, radio, or television artist may be taxed in New Zealand, but only if the artists’ gross receipts exceed US$10,000 for the year.

**460.65 Exempt daily allowances**

Film producers commonly pay a daily allowance to independent contractors and entertainers (actors, film crew, etc) working on film productions when they are working away from their normal place of residence. This allowance is intended to cover costs such as meals and minor incidental expenses. Such payments are classified as schedular payments and so are liable to tax. However, the CIR has issued a determination that up to $60 per day of a daily allowance is to be regarded as expenditure incurred in the production of the payment [see TIB vol 15:8 (August 2003) at 14-15].

The effect of this determination is that if the allowance is less than or equal to $60, then the whole of the allowance is exempt. If the allowance is more than $60, then $60 of the allowance is exempt and tax has to be deducted from the amount of the allowance that exceeds $60. However, the non-taxable amount is reduced on a pro rata basis to the extent that any goods or services, to which the allowance relates (eg meals), are provided to the contractor.

**Example 1:**

An actor on a film set receives a daily allowance of $60 while required to work away from their town of normal residence. The actor buys his own meals. The payer does not have to deduct tax because the total payment does not exceed $60 per day.

**Example 2:**

A worker on a film set receives a daily allowance of $60. The worker is also provided with all meals while working, either on the set, or at some other location. The worker has not incurred the expense herself so the exemption does not apply. The payer has to deduct tax from the entire allowance of $60.

**Example 3:**

Assume the same situation as in Example 2 except that the worker is provided with meals to the value of $20 per day. The payer will be required to deduct tax from $40 ($60 less $20).
Example 4:
An actor receives a daily allowance of $100. The actor incurs the expenses for which the allowance is paid herself. The payer must deduct tax from $40, the amount by which the allowance exceeds the $60 exemption.
# Financial Arrangements

## Chapter 470

### Income recognition under the financial arrangements rules

The financial arrangements rules are a timing regime for the purpose of s BD 4. These rules provide a legislative basis for taking the income and expenditure under a financial arrangement and spreading it over the life of that arrangement.

Some items that might otherwise be regarded as capital in nature are deemed by the financial arrangements rules to be income. Items of income calculated or derived under a financial arrangement are included in income by virtue of s CC 3. Expenditure incurred under the financial arrangements rules generally must meet the normal tests of deductibility.

**TaxNote:** The rules do not apply to foreign financial arrangements held by a transitional resident unless the arrangement is held for the purposes of a business carried on in New Zealand [see 370.35].

For reasons of compliance cost reduction, taxpayers whose financial arrangements have a low aggregate value may calculate their gross income and expenditure under those arrangements using the cash basis [see 470.65].

### Two parts to the regime

There are two parts to the rules governing financial arrangements. They are:

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(a) The financial arrangements rules; and
(b) The old financial arrangements rules.

(1) Old financial arrangements rules
The old financial arrangements rules relate to financial arrangements entered into from the implementation
date for that type of financial arrangement and before 20 May 1999. They are located in ss EZ 33 to EZ 52.

(2) Financial arrangements rules
The financial arrangements rules relate to financial arrangements entered into from 20 May 1999. They are
located in subpart EW and ss 90AA to 90AE of the TAA.

Section EW 10 governs which set of rules apply. The financial arrangements rules apply to all financial
arrangements to which any one or more of the following apply:

(a) Entered into from 20 May 1999;
(b) Existing immediately before 20 May 1999 to the extent to which a person becomes a party to it on
or after 20 May 1999. This would include such things as existing Government stock which is
purchased after that date; and
(c) Entered into before 20 May 1999 where the arrangement is rolled over or extended, or under which
an advance is made, from 20 May 1999.

The financial arrangements rules do not apply to a financial arrangement where all parties entered into it on
or after 20 May 1999 if they do so under a binding contract entered into prior to that date. The old financial
arrangements rules would apply.

Where a person becomes a party to a financial arrangement under a relationship agreement, the financial
arrangement rules apply if all of the following apply:

(a) The transferor was a party to it before 20 May 1999;
(b) It is rolled over or extended or an advance is made from 20 May 1999 under a binding contract entered
into before 20 May 1999; and
(c) It is transferred under a relationship agreement entered into from 20 May 1999.

Taxpayers may elect to move all of their financial arrangements which were entered into before 20 May 1999
from the old financial arrangements rules to the financial arrangements rules [s EZ 34]. A transitional
adjustment calculation is performed, and the resulting income or expenditure is included in the calculation
of their taxable income for the year of election [s EZ 51]. However, if the arrangement is not subject to the
financial arrangements rules (eg a small variable principal debt instrument), s EZ 51(9) requires the taxpayer
to treat the arrangement as transferred at market value. Therefore, the taxpayer must do a base price adjustment
under the old financial arrangements rules. Once a taxpayer has elected to move onto the financial
arrangements rules, the election cannot be revoked.

The commentary that follows concentrates on the financial arrangements rules, although some of the main
differences with the old financial arrangements rules are noted. For a full discussion of the old financial

470.15 Relationship with rest of Act [s EW 2]
A financial arrangement may be subject to both the financial arrangements rules and another income provision
or timing regime. In this situation, unless there is a specific section overriding the financial arrangements
rules, the financial arrangements rules take precedence.

For the sake of clarity, the section provides that expenditure under the financial arrangements rules is not
included as any of the following:

(a) The cost of trading stock, for low turnover traders;
(b) The cost of revenue account property;
(c) The cost of livestock;
(d) The cost of bloodstock;
(e) The cost of acquiring a film or a right in a film;
(f) Film production expenditure;
(g) The cost of timber; and
(h) Exploration expenditure or development expenditure in relation to petroleum mining.

470.20 Financial arrangements

“Financial arrangements” means:

“An arrangement under which a person receives money in consideration for that person, or another person, providing money to any person:

“(a) At a future time; or
“(b) On the occurrence or non-occurrence of a future event, whether or not the event occurs because notice is given or not given.”

Examples include:

(a) A debt, including a debt that arises by law;
(b) A debt instrument;
(c) The deferral of the payment of consideration for an absolute assignment of a person’s rights under another financial arrangement or under an excepted financial arrangement;
(d) The deferral of the payment of consideration for a legal defeasance releasing a person from some or all of their obligations under another financial arrangement or under an excepted financial arrangement.

The definition has broad coverage to encompass nearly all transactions where money is paid after a time elapse. The definition of money includes money’s worth (whether or not convertible into money) and the right to money (including the deferral or cancellation of any obligation to pay money, whether in whole or in part). Time has a “money’s worth” in many situations. The meaning of a financial arrangement encompasses many situations where the only money’s worth is obtained in consideration for future money’s worth. Therefore, land or assets are “money’s worth”, and so is a binding obligation to do something in the future.

(1) Old financial arrangements rules

For all practical purposes, there is little difference in the definition of financial arrangement. The old financial arrangements rules definition is located in s EZ 48.
470.25 Excepted financial arrangements [ss EW 5, EW 6, EW 8, EW 7]
The term “excepted financial arrangement” is defined in s EW 5 and means:

(a) An annuity for a term contingent upon human life or an annuity for a term that is not dependent on
human life to which s EY 8(2)(c) applies, in each case to the extent to which it is not “life financial
reinsurance”; 
(b) A bet on a race, a bet on a sporting event under a sports-betting system, and gambling, including a
New Zealand lottery; 
(c) An employment contract; 
(d) A farm-out arrangement; 
(e) An interest in a group investment fund; 
(f) A hire purchase agreement for livestock or bloodstock; 
(g) An insurance contract, to the extent to which it is not “life financial reinsurance”; 
(h) A lease that is not a finance lease; 
(i) A loan that is interest-free, repayable on demand and denominated in New Zealand dollars, for the
lender of the loan only; 
(j) An interest in a partnership or a joint venture; 
(k) A look-through interest for a look-through company; 
(l) A share lending arrangement; 
(m) Shares or an option to acquire or to sell shares; 
(n) A specified preference share to which s FZ 1 applies; 
(o) A membership of a superannuation scheme; 
(p) A warranty for goods or services; 
(q) An emissions unit; 
(r) A non-Kyoto greenhouse gas unit; 
(s) An agreement between a person (Person A) and another person (Person B) under which Person B
will provide property or services to Person A in consideration for a payment to Person B by a public
authority under a technology development grant or a technology transfer voucher; 
(t) For a transitional resident only, an arrangement where no other party to the arrangement is a New
Zealand resident and the arrangement is not for a purpose of a business carried on in New Zealand
by any party to the arrangement; 
(u) A loan in foreign currency for the borrower if the borrower is a cash basis person and uses the loan
for a private or a domestic purpose; 
(v) An option to acquire, sell, or dispose of property, other than an interest in a financial arrangement,
for a person who becomes a party to the option for a private or a domestic purpose only; 
(w) An agreement for the sale and purchase of property or services for private or domestic purposes where
settlement is required within 365 days and the subject matter is real property with a purchase price
of less than $1 million or other property or services with a purchase price of less than $400,000; 
(x) A specified option granted either to or by the person for private or domestic purposes which, if the
option is exercised, requires settlement of the property or performance of the services to take place
within 365 days of the granting of the option and the subject matter is real property with a purchase
price of less than $1 million or other property or services with a purchase price of less than $400,000; 
(y) An agreement for the sale and purchase of property or services if all of the sales and purchases of
property or services under the agreement are prepaid, and the total value of prepayments for all such
agreements on every day in that income year is $50,000 or less;
(z) A short-term agreement for the sale and purchase of property or services;
(za) A short-term option;
(zb) Travellers’ cheques;
(zc) A variable principal debt instrument if the total value, on every day in a particular income year, of all variable principal debt instruments to which a person is a party is $50,000 or less.

The limitation regarding “life financial reinsurance” in paras (a) and (g) above applies from 1 July 2010. However, where the life insurer chooses to apply the new life insurance rules for an income year that includes that date, the limitation applies from the beginning of that income year.

If an excepted financial arrangement of a type referred to in items (a) to (r) above is part of a financial arrangement, any amount solely attributable to the excepted financial arrangement is not taken into account under the financial arrangement rules. Conversely, if an excepted financial arrangement of a type referred to in items (s) to (zc) above is part of a financial arrangement, any amount solely attributable to the excepted financial arrangement is taken into account under the financial arrangement rules [s EW 6].

Where an arrangement of a type referred to in any of items (t) to (x) above ceases to be used for a private or domestic purpose, it ceases to be an excepted financial arrangement, and the person becomes a party to a financial arrangement, from (and including) that date [s EW 7].

(1) Election to treat excepted financial arrangement as financial arrangement [s EW 8]

Taxpayers can elect to treat as a financial arrangement the categories of excepted financial arrangement referred to in items (y) to (zc) above. Where such an election is made, it applies to all such financial arrangements to which the person is a party.

In addition, a person is able to choose to treat a class of short-term agreements for the sale and purchase of property or services as financial arrangements. The class must be identified by the currency of the agreement, the term of the agreement, or both. The election is made by including income derived or expenditure incurred under those financial arrangements in the person’s return of income. Such an election can be revoked by giving notice to the CIR by the due date for the filing of the income tax return. The revocation applies to financial arrangements entered into after the income year in which notice is given.

(2) Old financial arrangement rules

The Division 1 definition of excepted financial arrangement [s EZ 48] is not as comprehensive as the financial arrangements definition. Also, the categories of excepted financial arrangement that a taxpayer can elect to treat as a financial arrangement are restricted to certain classes of short-term agreements for the sale and purchase of property.

470.30 Further definitions

(1) Agreement for the sale and purchase of property or services

“Agreement for the sale and purchase of property or services” means a financial arrangement that is a conditional or an unconditional agreement to acquire or dispose of property or obtain or supply services; but does not include an option, a specified option, a forward or a futures contract.

(2) Finance lease

A “finance lease” is a lease of personal property entered into on or after 20 May 1999 which falls within either or both of the following:

(a) At the time at which it is entered into, the lease involves, or is part of, an arrangement which provides for one or more of the following:

   (i) The ownership of the asset to be transferred to the lessee or an associate of the lessee during, or at the end of, the term of the lease;

   (ii) The lessee or an associate of the lessee to have the option of acquiring the asset for an amount that is likely to be substantially lower than the asset’s market value on the date of acquisition;
(iii) A put or call option whereby an associate of the lessee acquires the lease asset during the lease term but does not entitle the associate to receive all of the lease payments that may fall due after the acquisition; or

(b) The term of the lease to be more than 75 per cent of the asset’s estimated useful life.

(3) **Property**

“Property” means any property, whether real or personal, legal or equitable, tangible or intangible, but does not include foreign exchange or a financial arrangement.

(4) **Short term agreement for sale and purchase**

“Short term agreement for sale and purchase” means an agreement for the sale and purchase of property or services to which any one or more of the following applies:

(a) Where settlement must take place, or services must be performed, on or before 93 days after the date on which the agreement is entered into;

(b) If the date on which the agreement is entered into cannot be established, an agreement under which settlement must take place or services must be performed on or before 93 days from the earlier of:
   (i) The date the buyer first makes a payment to the seller; or
   (ii) The date on which the first right in the contracted property is transferred or the services are performed; or

(c) If the agreement for the sale and purchase is continuous and the vendor renders periodic invoices for the property or services, an agreement under which settlement must take place or services must be performed on or before 93 days from the date on which each invoice is rendered.

(5) **Specified option**

“Specified option” means an option to acquire or dispose of property or services. The agreement for the sale and purchase of property or services, if any, entered into as a result of the option being exercised is treated as part of the option.

(6) **Old financial arrangement rules**

The old financial arrangement rules use the terms “holder” and “issuer” for the parties to a financial arrangement. These terms are not used in relation to the financial arrangement rules. For the purposes of the old financial arrangement rules, the holder is the person holding the financial arrangement, generally the lender, vendor, creditor, or the one who will ultimately receive the “money’s worth”. If A sells goods to B, A will be left holding the outstanding debt and will be the holder. More specifically, a holder is:

(a) A vendor in an agreement for sale and purchase of property, or a forward or futures contract;
(b) A grantor of the option in an option to purchase or acquire property;
(c) A grantee of an option to sell or dispose of property;
(d) A lessor for a hire purchase agreement;
(e) In other financial arrangements, a person who would receive or would be entitled to receive payment or pecuniary benefit if any amount (in whole or in part) were due and payable.

An “issuer” means a party to the financial arrangement who is not a holder. The issuer is the person who has issued the financial arrangement.

**Example:**

Emma, having purchased goods from Pauline, has issued a debt to Pauline. Emma is the issuer. Hence, the issuer is the borrower, purchaser, or debtor.

### 470.35 Financial arrangements rules not applicable [ss EW 9, EW 11]

The financial arrangements rules apply to a person who is a party to a financial arrangement.
The financial arrangements rules generally do not apply to a person who is not resident in New Zealand. However, they do apply to a non-resident:

(a) To the extent to which the person is a party to the financial arrangement for the purposes of a business carried on by the person through a fixed establishment in New Zealand; or

(b) If the person is a trustee for a New Zealand resident settlor. Even where there is a New Zealand resident settlor, the financial arrangements rules will not apply if there has been no settlement since 17 December 1987 or where the only settlements made since that date were made by non-resident settlors.

Where a non-resident is not subject to the financial arrangements rules, the following apply:

(a) If a commercial bill is disposed of, the value of the commercial bill on the day on which it is disposed of is income to the non-resident; or

(b) If a commercial bill is redeemed and the issuer of the commercial bill is an associated person of the non-resident, the amount received on redemption is income of the non-resident.

The financial arrangement rules do not apply to the following:

(a) The calculation of resident passive income;
(b) The calculation of non-resident passive income; or
(c) Interest paid by or to the CIR.

**470.35(1) Old financial arrangement rules**

There are similar exclusions under the old financial arrangement rules. One of the main exclusions is for financial arrangements issued or entered into before the relevant implementation date. The date varies depending on the type of financial arrangement:

- **Forward or future contracts, including those for foreign exchange, commodities, financial arrangements, excepted financial arrangements.** 8 pm NZST, 23 October 1986
- **Future contracts, trade credits, annuities, agreement for the sale and purchase of property and convertible notes.** 8 pm NZST, 23 October 1986
- **Debt defeasances and assignments of income.** 20 December 1986
- **Variable principal debt instruments.** 1 April 1987
- **Financial arrangements where monetary obligations are expressed in New Zealand dollars and the holder may require repayment on demand or call but it is not contemplated that the holder may advance further sums to the issuer on demand or call under the financial arrangement.** 1 April 1987
- **Every other financial arrangement.** 8.30 pm NZST, 31 July 1986

**470.40 Spreading methods [ss EW 12, EW 13, EW 14, EW 15]**

To comply with the financial arrangements rules, a person must allocate a fair and reasonable amount of income or expenditure to each income year over the term of the financial arrangement. The only exception is in the income year in which the base price adjustment calculation is required [see 470.80].

Cash basis persons are not required to spread income or expenditure but may choose to do so under s EW 61 [see 470.75].

From the 2009-2010 income year, a trustee who is a cash basis person and who holds a financial arrangement to manage compensation paid for personal injury under the various accident compensation Acts, or pursuant to a Court order, is not required to spread the income arising under that financial arrangement.

Also excluded from the requirement to spread are trustees who hold a financial arrangement in trust to manage compensation for personal injury under the Accident Insurance Act 1998, the Workers Compensation Act...
1956 or a court order, provided that the trustee is a cash basis person or would be if the trustee were a natural person.

The available spreading methods are:
(a) Yield to maturity [see 470.45];
(b) Straight-line [see 470.50];
(c) Market valuation [see 470.55];
(d) A method prescribed under a determination [see 470.60];
(e) A financial reporting method [see 470.65];
(f) IFRS financial reporting method [see 470.67];
(g) A default method.

Whichever method is used, the following items are included in the calculations:
(a) All consideration paid or payable to or by the person under the financial arrangement other than:
   (i) Non-contingent fees (if the IFRS method is not used), and;
   (ii) Non-integral fees (if either the IFRS method or the modified fair value method is used)
(b) All amounts that have been remitted or are to be remitted by the person under the financial arrangement; and
(c) All amounts that would have been payable to the person had those amounts not been remitted by law.

**470.45 Yield to maturity method** [ss EW 16, EW 19, EW 23]

The yield to maturity (YTM) method ceases to be the primary method of spreading income or expenditure under a financial arrangement from:
(a) The 2007-2008 income year; or
(b) At the taxpayer’s option, the first income year for which a person adopts IFRS for the purposes of financial reporting if that is before the 2007-2008 income year; or
(c) The 2008-2009 and later income years, if a person’s 2008-2009 income year starts before 1 January 2008 and the person has not adopted IFRS for the purposes of financial reporting before 1 January 2007.

The prime method that must be used where the taxpayer uses International Financial Reporting Standards (IFRS) for the preparation of financial statements and for the reporting of financial arrangements is the IFRS financial reporting method [see 470.67]. The yield to maturity method may be used only where the IFRS financial reporting method is not required to be used.

While YTM is not defined in the legislation, Determination G3 sets out how YTM is applied to financial arrangements, and Determination G1 sets out how the resulting income or expenditure is allocated to income years. YTM can be applied to a financial arrangement only if expected cash flows and payment dates for the financial arrangement are certain (eg YTM cannot be applied to financial arrangements with variable rates or when terms and conditions of a financial arrangement are varied).

An alternative to YTM may be used if it has regard to the principles of accrual accounting, conforms with commercially accepted practice and results in an allocation that is not materially different from that which would arise under YTM. There is a further requirement that the person also use that method for that type of financial arrangement for financial reporting purposes. This final requirement does not apply where all of the following conditions are met:
(a) The person consistently uses that method for financial arrangements of that sort;
(b) The method appropriately reflects the purpose for which the financial arrangement was entered into;
(c) The method has not been used for tax avoidance; and
(d) Its use has been approved by the CIR by way of notice or determination.
Financial Arrangements

470.50  **Straight-line method** [ss EW 17, EW 19, EW 25, EW 26]

The straight-line method can only be used if the person is a party to financial arrangements that have a total value of $1.85 million or less and the person is not required to use the IFRS financial reporting method [see 470.67]. Before the 2009-2010 income year, the threshold was $1.5 million.

Where the straight-line method is used, it must be used for all of the financial arrangements to which the person is a party. It then must continue to be used for the life of the arrangement until such time as a base price adjustment is required to be performed. A person is able to change from the straight-line method if they change to a method that is not a method for IFRS and the CIR’s written authorisation for the change has been obtained.

The straight-line method apportions interest amounts over the life of a financial arrangement on a pro rata basis. This approach is similar to that detailed in Determination G1A: *Apportionment of income and expenditure on a daily basis*, which is applied when apportioning amounts from “periods” to income years.

In certain limited circumstances the straight-line method will produce a result identical to yield to maturity:

(a) A discounted loan involving only one payment each by the holder and the issuer, such payments being not more than 12 months apart. For example, a zero-coupon bond redeemed within 12 months of purchase.

(b) A non-discounted fixed principal debt instrument with regular and fixed interest payments made not more than 12 months apart. For example, a five-year bank term deposit with non-reviewable interest paid semi-annually.

For other types of financial arrangement there will always be some difference in the amounts of income or expenditure calculated. Whether this difference is material is something that needs to be considered for each particular case.

If the amounts payable or receivable can be expressed with certainty in New Zealand currency, Determination G3 should be applied. An example of such a situation is a floating-rate foreign currency borrowing which is completely hedged for the term of the borrowing as to interest rates and to New Zealand currency.

470.55  **Market value method** [ss EW 18, EW 19, EW 23, EW 25, EW 26]

The (pre-IFRS) market valuation method is available only where the person is not required to use the IFRS financial reporting method [see 470.67]. Where the IFRS financial reporting method does not have to be used, the market value method is available on a restricted basis to persons who are carrying on a business that includes dealing in financial arrangements. A person who is a party to forward contracts for foreign exchange, futures and exchange-traded options may also apply the market valuation method of financial arrangements to those financial arrangements. All of the following further requirements for use of the method must also be met:

(a) The parties to the arrangement are not associated persons;

(b) Either the CIR has approved the market, the method and the source of information under a determination or that the person can demonstrate that the market prices used are reliable;

(c) The method conforms with commercially acceptable practice;

(d) The method is used for the life of the arrangement unless the CIR has given written authorisation that the method used be changed; and

(e) The method is used for financial reporting purposes for arrangements of that sort.

This final requirement does not apply where all of the following conditions are met:

(a) The person consistently uses that method for financial arrangements of that sort;

(b) The method appropriately reflects the purpose for which the financial arrangement was entered into;

(c) The method has not been used for tax avoidance; and

(d) Its use has been approved by the CIR by way of notice or determination.
A person is able to change from the market value method to a method that is not a method for IFRS provided that the CIR’s written authorisation for the change has been obtained.

**470.60 Determination method or alternative [ss EW 20, EW 23]**

A person is able to use a method prescribed by the CIR by way of determination for that type of financial arrangement where:

(a) The person is not required to use the IFRS method [see 470.67];
(b) The person cannot use the YTM method or an alternative; and
(c) Is not permitted to use, or chooses not to use, the straight-line method or a market valuation method.

For further details see 470.100 (Determinations) and 470.105 (Determinations issued).

**470.65 Financial reporting method [ss EW 21, EW 23]**

A person may use a financial reporting method where all of the following apply:

(a) A person cannot use YTM or an alternative;
(b) A person cannot, or chooses not to, use the straight-line or market valuation methods;
(c) The person does not use IFRS to prepare financial statements and to report for financial arrangements; and
(d) The CIR has not made a determination for the financial arrangement.

A person may use a financial reporting method, provided all of the following conditions are met:

(a) The method conforms with commercially acceptable practice;
(b) Is used by the person for financial reporting purposes; and
(c) Allocates a reasonable amount to each income year over the term of the financial arrangement.

The requirement that the method be used for that type of arrangement for financial reporting purposes is waived where all of the following apply:

(a) The person consistently uses that method for financial arrangements of that sort;
(b) The method appropriately reflects the purpose for which the financial arrangement was entered into;
(c) The method has not been used for tax avoidance; and
(d) Its use has been approved by the CIR by way of notice or determination.

**470.67 IFRS financial reporting method [ss EW 15B, EW 15C, EW 15D, EW 15E, EW 15FEW 15H, EW 15I, EW 25B]**

Taxpayers who are a party to a financial arrangement and who use International Financial Reporting Standards (IFRS) to prepare financial statements and to report for financial arrangements must use one of the following four methods to account for their financial arrangements for tax purposes [s EW 15C]:

(a) IFRS method [s EW 15D];
(b) A determination alternative [s EW 15E];
(c) Expected value method [s EW 15F]; and
(d) Fair value method (modified) [s EW 15G].

The fair value method is not able to be used where the financial arrangement is treated under IFRS by the person as a hedge of another financial arrangement and the person uses a method other than the IFRS financial reporting method for that other arrangement.

The methods must be applied using New Zealand dollars, notwithstanding that another currency may be used as the functional currency under IFRS.

The IFRS financial reporting method applies from:

(a) The 2007-2008 income year; or
(b) At the taxpayer’s option, the first income year for which a person adopts IFRS for the purposes of financial reporting if that is before the 2007-2008 income year; or

(c) The 2008-2009 and later income years, if a person’s 2008-2009 income year starts before 1 January 2008 and the person has not adopted IFRS for the purposes of financial reporting before 1 January 2007.

1 Compulsory determinations [s EW 15H]

The use of some of the determinations issued by the CIR is compulsory where the terms of the method described in the determination allows its use for the particular type of financial arrangement. The compulsory determinations are as follows:

(a) Determination G5C: Mandatory conversion convertible notes (or a determination that succeeds it);

(b) Determination G22: Optional conversion convertible notes denominated in New Zealand dollars convertible to the option of the holder (or a determination that succeeds it);

(c) Determination G22A: Optional convertible notes denominated in New Zealand dollars (or a determination that succeeds it);

(d) Determination G29: Agreements for sale and purchase of property denominated in foreign currency: exchange rate to determine the acquisition price and method for spreading income and expenditure (or a determination that succeeds it);

(e) An alternative method to the methods described above if that alternative has regard to the purposes of the financial arrangements rules under s EW 1(3), is for financial arrangements similar to those arrangements to which the above methods may apply, and results in the allocation to each income year of amounts that are not materially different from the result using one of the methods described above.

2 Where compulsory determinations do not apply [s EW 15I]

Where none of the above compulsory determinations applies, and the financial arrangement:

(a) Includes in part an excepted financial arrangement;

(b) Is treated (either wholly or in part) by the taxpayer or by the issuer of the arrangement as an equity instrument under IFRS; or

(c) Is an agreement for the sale and purchase of property or services;

the person must then (if available), use one of the following methods:

(a) Yield to maturity method [see 470.45];

(b) Determination G26: Variable rate financial arrangements (or a determination that succeeds it); or

(c) A determination made by the CIR under s 90AC(1)(bb) of the TAA; or

(d) An alternative method to those described above, provided the alternative method has regard to the purposes of the financial arrangements rules under s EW 1(3), is for financial arrangements similar to those arrangements to which the methods described above may apply; and results in the allocation to each income year of amounts that are not materially different from the result using one of the methods described above.

3 Where arrangement does not include an excepted financial arrangement

Where the arrangement does not include an excepted financial arrangement, is not treated as an equity instrument under IFRS, and is not an agreement for the sale and purchase of property or services, one of the following methods must be used:

(a) IFRS method [s EW 15D];

(b) A determination alternative [s EW 15E];

(c) Expected value method [s EW 15F]; or

(d) Modified fair value method [s EW 15G].
(4) **IFRS method [s EW 15D]**

Where none of the preceding paragraphs applies and the taxpayer does not use an allowable alternative method, the IFRS method must be used. This entails allocating income (or loss) to each income year in accordance with IFRS, but with the following modifications (where relevant):

(a) Where the financial arrangement is a financial asset, amounts arising from an “impaired credit adjustment” under IFRS is reversed out. This does not apply where the fair value method is used, the financial arrangements are not derivative instruments, and the person’s business includes dealing in those financial arrangements;

(b) Borrowing costs are not capitalised under NZIAS 23;

(c) An amount arising from the fair value method under IFRS is included for tax purposes, even though the amount is allocated to equity reserves under IFRS.

An “impaired credit adjustment” means:

(a) Where the fair value method is used, the movement in fair value due to the decline in credit quality of the arrangement;

(b) Where the fair value method is not used, the credit impairment adjustments made under IFRS.

(5) **Determination alternatives to IFRS [s EW 15E]**

The determination alternatives to IFRS contained in s EW 15E apply where the taxpayer chooses to use them in a return of income. However, the following conditions must be met:

(a) The terms of the relevant method (modified as described below) allow the person to use it for the financial arrangement; and

(b) The person:
   (i) Does not treat the financial arrangement under IFRS as a hedge of a financial arrangement; or
   (ii) Treats the financial arrangement under IFRS as a hedge of other financial arrangements for which the person does not use the fair value method; or
   (iii) Treats the financial arrangement under IFRS as a hedge of something that is not a financial arrangement.

The determination alternatives (modified as described below) are:

(a) Determination G3: *Yield to maturity*, but only if the financial arrangement is denominated in New Zealand currency and is not a derivative instrument. When applying Determination G3, Determination G25: *Variation in the terms of a financial arrangement* must be used;

(b) Determination G9C: *Financial arrangements that are denominated in a currency other than New Zealand dollars: an expected value approach* (or a determination that succeeds it);

(c) Determination G14B: *Forward contracts for foreign exchange and commodities: an expected value approach* (or a determination that succeeds it);

(d) Determination G27: *Swaps* (or a determination that succeeds it);

(e) A determination made by the CIR under s 90AC(1)(bb) of the TAA; or

(f) An alternative method to those described above, if that alternative has regard to the purposes of the financial arrangements rules under s EW 1(3), is for financial arrangements similar to those to which the methods described above may apply, and results in the allocation to each income year of amounts that are not materially different from the result using one of the methods described above.

The required determination modifications referred to above relate to the use of Determinations G9C: *Financial arrangements that are denominated in a currency other than New Zealand dollars: an expected value approach*, and G14B: *Forward contracts for foreign exchange and commodities: an expected value approach*.
The required modifications are as follows:

(a) The term “forward contract” is treated as including a conditional or unconditional agreement to pay or be paid an amount calculated by reference to the price of property or services, without the property being delivered or the services being performed;

(b) A requirement that all members of a group of companies to which the person belongs make an election to use the determination alternative is treated as met if:
   (i) All members of the group of companies make an election on or before the sixty-third day after the person enters into the relevant financial arrangement, or such further time as the CIR may allow; and
   (ii) The financial arrangement is the first financial arrangement of the group of companies for which Determinations G9C or G14B may be used; and
   (iii) The election to use Determinations G9C or G14B is in writing.

(c) Where the determination alternative is Determination G27: Swaps, the allocation is modified in that only method C is to be used and, for method C, Determination G9C: Financial arrangements that are denominated in a currency other than New Zealand dollars: an expected value approach, must be used, rather than Determination G9A.

6) Expected value method [s EW 15F]

The expected value method can be used where all of the following conditions are met:

(a) The financial arrangement is denominated in a currency other than New Zealand dollars or is a derivative instrument as defined in NZ IAS-39;

(b) The person:
   (i) Does not treat the financial arrangement under IFRS as a hedge of a financial arrangement; or
   (ii) Treats the financial arrangement under IFRS as a hedge of other financial arrangements for which the person does not use the fair value method; or
   (iii) Treats the financial arrangement under IFRS as a hedge of something that is not a financial arrangement.

(c) The person is not in the business of dealing in the financial arrangement;

(d) The person has entered into the financial arrangement in the ordinary course of their business; and

(e) The person and all members of a group of companies to which the person belongs have elected in writing to use the expected value method. An exception to this requirement applies to a member company that does not have a business of a substantially similar nature to a business of another company in the group and the financial arrangement is with other parties where either:
   (i) None are associated with the person or a member of the group; or
   (ii) All are associated with the person and use the method used by the person for the arrangement.

The method chosen must have the features of an expected value approach described in Determinations G9C and G14B, and must result in the allocation of a reasonable amount, having regard to the purposes of the financial arrangements rules under s EW 1(3) for each income year over the term of the arrangement.

7) Modified fair value method [s EW 15G]

The modified fair value method can be used where all of the following conditions are met:

(a) A person has entered into the financial arrangement in the ordinary course of their business;

(b) The person is not in the business of dealing in relation to the financial arrangement;

(c) The financial arrangement is denominated in a foreign currency or is a derivative instrument;

(d) The person:
(i) Does not treat the financial arrangement under IFRS as a hedge of a financial arrangement; or
(ii) Treats the financial arrangement under IFRS as a hedge of other financial arrangements for which the person does not use the fair value method; or
(iii) Treats the financial arrangement under IFRS as a hedge of something that is not a financial arrangement; and

(e) The person and all members of a group of companies to which the person belongs have chosen to use the modified fair value method and have notified the CIR at the time of filing a return of income. An exception to this requirement applies to a member company where:

(i) The company is not otherwise required by this section to use the modified fair value method; and
(ii) The company does not have a business of a substantially similar nature to a business of another company in the group; and
(iii) The financial arrangement is with other parties where either none is associated with the person or a member of the group, or all are associated with the person and use the method used by the person for the arrangement.

When using the modified fair value method, the taxpayer must use the IFRS method to account for income and expenditure under the financial arrangement. However, an amount which has been allocated to equity reserves under IFRSs is excluded for tax purposes. Also excluded any amount in respect of the financial arrangement which is not allocated by the company to equity reserves under IFRS provided that all of the following criteria are satisfied:

(i) The company is a member of a wholly-owned group;
(ii) The financial arrangement is related to an arrangement of another company in the group (Company B);
(iii) The company and Company B are members of the same group consolidated under IFRS;
(iv) Company B does not use the fair value method or the other arrangement; and
(v) The consolidated group makes an allocation of a corresponding amount to equity reserves under IFRS.

Where the company or the consolidated group allocates an amount or the arrangement to equity reserves under IFRS and a member of the consolidated group (Company B) does not allocate an amount for the financial arrangement to the income year for tax purposes, the company must use the modified fair value method for the financial arrangement.

(8) Consistency requirement [s EW 25B]

Where a person uses one of the methods available under the IFRS financial reporting method, that method must be used for:

(a) The remaining term of the financial arrangement until the base price adjustment is required to be performed [see 470.80]; and
(b) All other financial arrangements that are the same as, or similar to, that financial arrangement unless a different accounting treatment under IFRS is used for a particular financial arrangement.

This rule is overridden in the following circumstance. A change in the specific individual method used under the IFRS financial reporting method is allowed where the accounting treatment for the relevant financial arrangement under IFRS is changed for financial reporting purposes in the same income year. A spreading method adjustment is required to be performed under s EW 26 [see 470.70] unless:

(a) The method being changed from is the fair value method and relates to a financial arrangement that is not subject to a creditor workout; or
(b) The change is from the (pre-IFRS) market value method to an IFRS method.
In both of these cases, a base price adjustment must be performed [s EW 29].

**470.70 Changing methods** [ss EW 26, EZ 52C]

A person may change from the straight-line method or market valuation method to a method that is not a method for IFRS under s EW 15B [see 470.67] provided that they have written authorisation of the CIR.

A change may be made from other methods if there is a good commercial reason (other than income tax advantage) for doing so. The term “good commercial reason” is deemed to include starting to use, or ceasing to use IFRS for financial reporting purposes at the same time as starting or ceasing to use an IFRS method for tax purposes. Where a change in method is made, a “spreading method adjustment” must be made for the year in which the method is changed. The spreading method adjustment is the only income or expenditure that arises under the financial arrangement for that income year.

The formula for the spreading method adjustment is:

\[
\text{income (new method)} - \text{expenditure (new method)} - \text{income (old method)} + \text{expenditure (old method)}
\]

Where:

"Income (new method)” and “expenditure (new method)” are the income and expenditure (respectively) that would have been derived or incurred under the financial arrangement if the new method had been used from the time at which the person became a party to the financial arrangement until the end of the income year for which the adjustment is being calculated.

"Income (old method)” and “expenditure (old method)” are the income and expenditure derived and incurred by the person under the financial arrangement in previous income years.

In the formula, the effect of the application of the formula is to place the person in the position in which they would have been had the new method been used from the outset.

The change of method adjustment is not required where a person changes the spreading method for a particular financial arrangement from the fair value method under the IFRS method [see 470.67] and the financial arrangement is not subject to a creditor workout. Neither is the change of method adjustment required to be performed where the person changes from the (pre-IFRS) market value method to a method for IFRS under s EW 15B. In these cases, a base price adjustment is required to be performed under s EW 29(13) [see 470.80].

The change of method adjustment is prohibited from being used where a person changes from using Determination G22: *Optional convertible notes denominated in New Zealand dollars convertible at the option of the holder* to using Determination G22A: *Optional convertible notes denominated in New Zealand dollars*. Instead, Determination G22 applies for the part year before the change and Determination G22A applies for the part year following the change [s EZ 52C].

**470.75 Cash basis persons** [ss EW 54, EW 55, EW 56, EW 57, EW 58, EW 59, EW 60, EW 61]

A cash basis person is not required to use a spreading method to spread the income or expenditure under a financial arrangement. Instead, the income of expenditure is returned on a cash receipts or cash payments basis. A base price adjustment still must be calculated where any of the circumstances in ss EW 29(1) to EW 29(13) applies [see 470.80].

From the 2009-2010 income year, a cash basis person is a person who (for the income year in question), meets the following threshold tests:

(a) In the income year the absolute value of the person’s income or expenditure from the financial arrangements is not more than $100,000; or

(b) On every day in the income year all of the person’s financial arrangements have a total value of not more than $1 million.
In addition, the deferral threshold must not be breached. The deferral threshold will be breached if the cash basis results in a deferral of income or an acceleration of expenditure of more than $40,000 in aggregate. Any of the above thresholds are able to be increased by way of Order in Council.

In determining whether any of the thresholds have been breached, the financial arrangements under both the old financial arrangement rules and the financial arrangement rules must be taken into account. The formula for calculating the deferral is:

\[(\text{accrual income} - \text{cash basis income}) + (\text{cash basis expenditure} - \text{accrual expenditure})\]

Where:

“Accrual income” is the income derived from the date on which the person became a party to the arrangement to the end of the income year for which the calculation is being made using a spreading method;

“Accrual expenditure” is the expenditure incurred from the date on which the person became a party to the arrangement to the end of the income year for which the calculation is being made using a spreading method;

“Cash basis income” is the income derived from the date on which the person became a party to the arrangement to the end of the income year for which the calculation is being made using the cash basis;

“Cash basis expenditure” is the expenditure incurred from the date on which the person became a party to the arrangement to the end of the income year for which the calculation is being made using the cash basis.

Both “accrual income” and “accrual expenditure” must be calculated using the yield to maturity method, straight-line method or an alternative method approved by the CIR. Yield to maturity and straight-line can be used for this purpose whether or not the method is available to the person for the arrangement. The calculations apply to each financial arrangement to which the person is a party but only to the extent of the person’s interest in it. Where a financial arrangement is held by a bare trust, each beneficiary makes the calculation to the extent of that beneficiary’s share in the arrangement.

The CIR may treat a person who would otherwise be a cash basis person for a class of financial arrangements as not being a cash basis person where either or both of the following apply:

(a) Any person has structured and promoted that class of financial arrangement with a view to deferring an income tax liability; or

(b) The parties to the financial arrangement are associated persons who do not calculate income and expenditure under the financial arrangement in the same manner.

Before the 2009-2010 income year, the cash basis concession was available only to parties to a financial arrangement who were natural persons, other than trustees. A trustee of a deceased estate was a cash basis person only if, at the time of death, the deceased person was a cash basis person and the financial arrangements did not exceed the thresholds. This concession applied only for the income year of death and the following four income years. The concession ceased to apply if (at any time), the thresholds were breached. Once the trustee ceased to be a cash basis person, the cash basis could not apply in the future [s EW 60].

Cash basis persons may elect to use a spreading method rather than the cash basis method of calculating income and expenditure under the financial arrangements rules. This election cannot be made in the year in which a base price adjustment must be made. The election must be made for all financial arrangements to which the person is a party at the time of the election and any financial arrangements entered into in subsequent years. The person must continue to use the spreading method for those financial arrangements until the financial arrangements mature. The election can be revoked by giving notice to the CIR. The revocation will then apply to financial arrangements entered into after the income year in which the notice of revocation is given.

When moving between the cash basis and an accrual basis of accounting for a financial arrangement, a cash basis adjustment must be performed [see 470.85].

1. Old financial arrangement rules

Under the old financial arrangement rules, the cash basis concession is available only to holders of financial arrangements. It is not available to issuers. Cash basis taxpayers who are eligible to use the cash basis concession must do so.
The thresholds under the old financial arrangement rules are lower than those under the financial arrangement rules.

A cash basis holder is a natural person where either:

(a) The income derived in that income year, calculated under the financial arrangements rules does not exceed $70,000; or

(b) The value of financial arrangements held in the income year at any time does not exceed $600,000; and

(c) The difference between:
   (i) Income under the financial arrangements held at the end of the income year using either a yield to maturity, straight-line, or another approved method; and
   (ii) Income as a cash basis holder does not exceed $20,000.

**Base price adjustment** [ss EW 28, EW 29, EW 30, EW 31]

The base price adjustment is the “wash-up” calculation in the year of sale, maturity, remission or other disposal or transfer of a financial arrangement. The base price adjustment applies to both accrual and cash basis taxpayers.

A person who is a party to a financial arrangement must calculate a base price adjustment when any one or more of the following circumstances arise:

(a) The person ceases to be resident in New Zealand;

(b) A non-resident who holds the financial arrangement as part of a business carried on through a fixed establishment in New Zealand ceases to hold it for that purpose;

(c) The financial arrangement matures. This includes the situation where the amount remaining to be paid is immaterial and the arrangement has been structured to avoid the necessity to perform a base price adjustment;

(d) The financial arrangement is disposed of, or is deemed to be disposed of because:
   (i) A non-resident leaves the tax base;
   (ii) An in-kind, or in specie distribution of a financial arrangement is made by a company in liquidation;
   (iii) A party to a financial arrangement has died (for the deceased person);
   (iv) The financial arrangement is distributed to a beneficiary under a will or on intestacy.

(e) For an assignor or defeasor, an absolute assignment or legal defeasance of a debt is made;

(f) The person is a debtor and the debt is sold at a discount by the creditor to an associate of the debtor;

(g) A party to the financial arrangement is released from making all remaining payments without fully adequate consideration;

(h) A party to the financial arrangement is released from making all remaining payments by a deed or agreement of composition with the party’s creditors, by operation of law or by lapse of time.

A base price adjustment need not be performed by the following:

(a) A temporary resident who is a cash basis person who becomes non-resident for tax purposes within three years, provided the temporary resident was party to the financial arrangement before first becoming a New Zealand resident;

(b) A New Zealand resident who becomes non-resident if the financial arrangement continues to be held in relation to a business carried on by the person through a fixed establishment in New Zealand; and

(c) Taxpayers who are a party to a debt that has been legally defeased, and are not the defeasor.

A base price adjustment must not be performed where the person has assigned the rights under a financial arrangement absolutely, or their obligations have been defeased under a legal defeasance, if all or part of the
consideration for the assignment or defeasance is deferred. Under these circumstances, the deferred consideration is taxed on an accrual basis over the term of the arrangement.

The base price adjustment formula is:

\[ \text{consideration} - \text{income} + \text{expenditure} + \text{amount remitted} \]

Where:

“Consideration” is the consideration paid or payable to the person less the consideration paid or payable by the person — in both cases ignoring non-contingent fees (where the method is not the IFRS method) and non-integral fees (where the method is the IFRS method). Note that various provisions stipulate what “consideration” means under particular circumstances [see 470.90].

“Income” is:

(a) Income derived by the person under the financial arrangement in previous income years [s CC 3];
(b) Dividends derived by the person from the release of the obligation to repay the amount lent [ss CD 3(1), CD 4(1), (2), CD 5(1)]; and
(c) Income derived under s CF 2(2) and (3) (Remission of specified suspensory loans).

“Expenditure” is expenditure incurred by the person under the financial arrangement in previous income years;

“Amount remitted” is an amount that is not included in the consideration paid or payable to the person, because it has been remitted either by the person or by operation of law.

If the result is positive, the amount is income in the year for which the calculation is made. If the result is negative, the amount is expenditure incurred in the year for which the calculation is made. However, if the outcome of the base price adjustment is positive (income) to the extent to which the amount arises because of expenditure incurred in prior years but the expenditure was not allowed as a deduction, the amount is not be treated as income under the base price adjustment.

**470.85 Adjustment for person becoming or ceasing to be a cash basis person [ss EW 62, EW 63]**

Where a person becomes or ceases to be a cash basis person during an income year, an adjustment is required to be made. Where a person is becoming a cash basis person, no adjustment is made in respect of financial arrangements which are already being accounted for on a cash basis. Similarly, where a person is ceasing to be a cash basis person, no adjustment is required in respect of a financial arrangement that is already being accounted for on an accrual basis.

The adjustment formula is:

\[ \text{adjusted income} - \text{adjusted expenditure} - \text{previous income} + \text{previous expenditure} \]

Where:

“Adjusted income” is:

(a) For a person who becomes a cash basis person, the total amount that would have been income derived by the person from the financial arrangement if the person had been a cash basis person from the date on which the person became a party to the financial arrangement to the last day of the income year for which this calculation is made; and

(b) For a person who stops being a cash basis person, the total amount that would have been income derived by the person from the financial arrangement under the financial arrangements rules from the date on which the person became a party to the financial arrangement to the last day of the income year for which this calculation is made;

“Adjusted expenditure” is:

(a) For a person who becomes a cash basis person, the total amount of expenditure that a cash basis person would have incurred under the financial arrangement from the date the person became a party to the financial arrangement to the last day of the income year for which this calculation is made; and
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(b) For a person who stops being a cash basis person, the total amount of expenditure that would have been incurred under the financial arrangement by applying the accrual rules from the date on which the person became a party to the financial arrangement to the last day of the income year for which this calculation is made.

“Previous income” is the total amount of income of the person from the financial arrangement in all income years before the income year in which this calculation is made;

“Previous expenditure” is the total amount of expenditure incurred by the person under the financial arrangement in all income years before the income year in which this calculation is made.

If the result of the cash basis adjustment is a positive amount, it is income derived by the person in the income year. If the result is a negative amount, it is expenditure incurred by the person in the income year.

In the income year in which the cash basis adjustment is made, that is the only amount that is income derived or expenditure incurred under the financial arrangement for that income year.

470.90 Consideration [ss EW 31, EW 32, EW 33, EW 34, EW 35, EW 36, EW 37, EW 38, EW 39, EW 40, EW 41, EW 42, EW 43, EW 44, EW 45, EW 46, EW 46B, EW 47, EW 48, EW 49, EW 50, EW 51]

The term “consideration” is vital to the calculation of income and expenditure under the financial arrangements rules. While in most cases its meaning is obvious, it has different meanings under different circumstances.

(1) Consideration includes property or services [ss EW 32, EW 34]

Where the consideration includes property or services, “consideration” for an original party to an arrangement that is a finance lease, hire purchase agreement, agreement for the sale and purchase of property or services, or a specified option is which ever of the following first applies:

(a) The lowest price that the parties would have agreed to on the date on which the agreement was entered into on the basis of payment in full on the date on which the first right in the property passes or the services are performed. This does not apply to an agreement for sale or purchase of property or services that is part of another financial arrangement;

(b) The cash price of the property or services to which the agreement relates determined under s 5 of the Credit Contracts and Consumer Finance Act 2003 if applicable;

(c) The future value, discounted value (or a combination of both) paid or payable on the date on which the first right in the property is transferred or the services are provided, as determined by a CIR determination; or

(d) The amount determined by the CIR if either party applies for a specific determination.

Where paragraph (a) applies, and the lowest price is in a foreign currency, the conversion rate is to be selected from the following:

(a) A rate obtained from a New Zealand registered bank for the date on which the first right in property passes or is expected to pass;

(b) A rate obtained from a New Zealand registered bank for the date on which the final payment is to be made. This rate can be used only where the period between the date on which the first right in property passes and the date on which the final payment is to be made is not more than five years; or

(c) A rate approved by the CIR by way of determination.

(2) Changing from fair value method under the IFRS method to any other method [s EW 46B]

Where a person changes from the fair value method to any other method for any financial arrangement, the person is treated as having been paid consideration equal to the market value of the financial arrangement at the end of the first income year for which the replacement method is used for that financial arrangement. A base price adjustment must be performed at that time.
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(3) **Hire purchase agreement or finance lease [s EW 33]**

The consideration for a hire purchase agreement or finance lease includes an amount incurred by the lessor in preparing or installing the asset for use.

(4) **Exiting the financial arrangement rules [ss EW 36, EW 41]**

Where a person:

(a) Ceases to be New Zealand resident and does not hold the financial arrangement as part of a business carried on through a fixed establishment in New Zealand;

(b) Is a non-resident and ceases to be a party to an arrangement for the purposes of a business carried on through a fixed establishment in New Zealand; or

(c) Starts using the financial arrangement for private or domestic purposes and it becomes an excepted financial arrangement:

(i) The person is deemed to have disposed of any accrued entitlement under the financial arrangement at the market value of that entitlement; and

(ii) The person is deemed to have been relieved of any accrued obligation immediately before the time and to have paid the market value of a contract to assume the obligation at that time.

(5) **Entering the financial arrangement rules [ss EW 37, EW 42]**

Where a person is a party to a financial arrangement and the person:

(a) Becomes New Zealand resident and did not previously hold the financial arrangement as part of a business carried on through a fixed establishment in New Zealand;

(b) Is a non-resident (other than a transitional resident) and becomes a party to an arrangement for the purposes of a business carried on through a fixed establishment in New Zealand;

(c) Is a transitional resident and the arrangement ceases to be an excepted financial arrangement or the person ceases to be a transitional resident under s EW 5(17) [see 470.25]; or

(d) Stops using the financial arrangement for private or domestic purposes and it ceases to be an excepted financial arrangement.

Under each of these circumstances:

(a) The person is deemed to have paid the market value of any accrued obligation under the financial arrangement at that time; and

(b) The person is deemed to have acquired for market value any accrued entitlement under the financial arrangement at that time.

(6) **Disposal or acquisition for no or inadequate consideration or as a distribution in kind or for non-monetary consideration [ss EW 38, EW 42]**

If a person has an accrued entitlement under a financial arrangement and disposes of it for no consideration or for less than market value consideration, or for non-monetary consideration, the person is deemed to have received market value consideration for the entitlement.

If a person becomes party to a financial arrangement and acquires an entitlement other than for monetary consideration or for less than market value, the person is treated as having paid the market value of that entitlement at that time.

(7) **Consideration affected by unfavourable factors [s EW 39]**

If a person sells or transfers an arrangement for an amount influenced by any one or more of the following:

(a) A decline in the other person’s credit worthiness;

(b) An increase in the possibility that the other person would default on an obligation under the arrangement; or

(c) An event the reduces or cancels the other parties obligations,
the person is treated as having received the amount that would have been received had it not been for that circumstance. However, this provision does not apply where the person’s business includes holding or dealing in financial arrangements of that class and the parties to the arrangement are not associated.

(8) **Debtor released from obligation** [s EW 45]

Where a debtor is released from an obligation to pay amounts under a financial arrangement under s 304 of the Insolvency Act 2006, any of the Revenue Acts or under a social assistance suspensory loan, the person is treated as having paid the amount on the day on which they are released from the obligation.

(9) **Early withdrawal of term deposit** [s EW 31]

Where a term deposit is withdrawn in whole or in part before the contractual maturity date, and the rate of interest is reduced as a result of the early withdrawal resulting in the depositor having to either repay interest or receive a reduced repayment of principal, public binding ruling BR Pub 10/21 applies [see TIB vol 23:1 (February 2011) at 15].

Where the deposit is withdrawn in full, a base price adjustment is required [see 470.80]. The amount of repaid interest is included in “consideration” for the purposes of the base price adjustment and, if the result is a negative amount, it is deemed to be interest expenditure. This interest may be deductible under s DB 6 (Interest: not capital expenditure) or s DB 7 which allows companies to take an interest deduction without having to prove a nexus with income. To the extent to which the person has returned income from the financial arrangement in earlier income years, the deduction is automatically allowable.

Where only part of the term deposit is withdrawn, no base price adjustment is required to be performed at the time of early withdrawal. Instead depositors who are not cash basis persons, and cash basis persons who have elected to use a spreading method, are required to apply determination G25: *Variations in the terms of a financial arrangement* [see 470.105]. Cash basis persons are able to deduct the interest repaid at the time it is incurred provided there is sufficient nexus between the repayment of interest and the interest income derived such that the general permission is satisfied. In the CIR’s opinion as set out in the ruling, this will be the case only where the interest repayment was incurred in the course of carrying on a business. In all other cases, the repayment will be dealt with in the case price adjustment performed at maturity.

(10) **Legal defeasance** [s EW 47]

Where all of the following circumstances apply:

(a) A financial arrangement has been subject to a legal defeasance;

(b) Another person has been required to meet the remaining obligations under the arrangement; and

(c) The person who has a right to receive money under the arrangement is required to perform a base price adjustment in respect of the arrangement,

the consideration received by a person is the aggregate of the amounts received from the original debtor and the amounts received from the other person.

(11) **Anti-avoidance** [s EW 48]

Where:

(a) Parties to a financial arrangement have dealt with each other in such a way that the intention of the financial arrangements rules has been defeated and s GB 21 applies; or

(b) The amount payable by the person is excessive under a transfer-pricing arrangement and s GC 7 applies; or

(c) The amount receivable under a transfer-pricing arrangement is insufficient and s GC 8 applies,

the consideration is deemed to be the amount that it would have been if the parties had been independent and had been dealing with each other at arm’s length.
(12) Debt sold at a discount to associate of the debtor [ss EW 43, EW 49]
Where a creditor sells a debt to an associated person [see 70 ASSOCIATED PERSONS AND RELATIVES], for a discount of at least 20 per cent of the market value, the following consequences arise:

(a) The debtor is treated as having paid the creditor the amount that the associated person pays to the creditor for the debt. This results in a base price adjustment being required to be performed by both the debtor and the original creditor with resultant remission income for the creditor; and

(b) The associated person is treated as having provided the debtor with an interest-free loan of the amount paid for the debt. If the debtor later repays the associated person more than the amount that the associated person paid for the debt, the excess amount is income of the associated person and a deduction for the debtor.

When determining whether or not the 80 per cent threshold has been breached, it is necessary to determine the market value of the debt. If the market value of the debt has been affected by one or more of the following factors:

(a) A decline in the debtor’s credit worthiness after the date on which the debt was entered into;

(b) An increase in the likelihood of the debtor defaulting; or

(c) An event that reduces or cancels the debtor’s obligations,
the market value is deemed to be the amount which it would have been had that factor not existed.

(13) Debt forgiven for natural love and affection [ss EW 44, EW 50]
An amount owing under a debt (including accrued interest) may be forgiven by a natural person in consideration of natural love and affection. A debt owed by a trust may also be forgiven in consideration of natural love and affection if the trust is either intended primarily to benefit a natural person for whom the creditor has natural love and affection, a charitable organisation, or both. In these situations, the forgiven amount is treated as paid when it is forgiven [see TES 20 (October 2004) 283].

The same treatment applies where a resettlement is made to a trust which has been established primarily to benefit charities or natural persons for whom the creditor has natural love and affection. Where a forgiveness is conditional, the amount forgiven is not treated as paid until the conditions are fulfilled. However, if a trust distributes any amounts to a natural person for whom the creditor does not have natural love and affection or to a non-charitable organisation, the distribution is income of the trustee to the extent that the distribution is less than or equal to the total amount forgiven by the creditor, and is included in income in the income year in which the distribution is made.

470.95 Anti-avoidance provisions [s EW 53]
Adjustments are required where the terms of a financial arrangement meet all of the following criteria:

(a) The terms of the financial arrangement give any party to the arrangement, or an associated person of any party to the financial arrangement, the discretion to decide any amount payable under the financial arrangement;

(b) The exercise of the discretion does not reflect changes in economic, commodity, industrial, or financial indices or changes in banking or general commercial rates;

(c) The making of the financial arrangement is not generally accepted commercial practice; and

(d) The effect of the financial arrangement is to defeat the intention of the financial arrangements rules.

Where the criteria set out above are met, each party must make adjustments to the financial arrangement for the following income years:

(a) The income year in which the person ceases to be a party to the financial arrangement;

(b) Where the person remains a party to the financial arrangement at the end of the fifth income year following the income year during which the person became a party to the financial arrangement in that fifth income year; or
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(c) In every fifth income year following the year in which the previous adjustment was required to be made until such time as the person ceases to be a party to the financial arrangement, in which case an adjustment is required under paragraph (a) above.

In making the adjustment, the person is required to calculate income and expenditure under the financial arrangement for each income year using the yield to maturity method. The following amounts must be included in the calculation:

(a) All consideration that has been paid, is payable, or will be payable to or by the person other than:
   (i) Non-contingent fees (if the IFRS method is not used); and
   (ii) Non-integral fees (if the IFRS method is used);
(b) All amounts that have been, or are to be, remitted by the person; and
(c) All amounts that would have been payable to the person had they not been remitted by operation of law.

“Non-contingent fees” are defined as a fee that is:
(a) For services provided for a person becoming a party to a financial arrangement; and
(b) Payable whether or not the financial arrangement proceeds.

“Non-integral fees” are defined as a fee or transaction cost that, for the purposes of financial reporting under IFRS, is not an integral part of the effective interest rate of the financial arrangement.

For every fifth income year, the person must also include an amount equal to the arrangement’s market value on the last day of the income year as if the person had disposed of the arrangement for that amount. If the arrangement has no market value the amount that reasonably could be expected to be realised on an arms-length disposal is used instead. Once these calculations have been done, the person is required to recalculate the income tax liability for each income year using those amounts of income or expenditure in substitution for the amounts previously calculated for each income year.

470.100 Determinations [TAA, ss 90AA, 90AB, 90AC, 90AD]

The CIR may make determinations. They may apply generally to all financial arrangements or just to a class of financial arrangements. They may apply to all persons or just to a class of persons. Determinations can be made in respect of the following matters:

(a) How the yield to maturity method applies to any financial arrangement;
(b) How the straight-line method applies to any financial arrangement;
(c) The method that may be used in determining the income or expenditure incurred for compulsory methods under the IFRS financial reporting method and determination alternatives to IFRS;
(d) The market, the method or methods, and the source of information used to determine market values used where the business is engaged in dealing in financial arrangements or the financial arrangement is a futures contract or a forward or future contract for foreign exchange;
(e) The methods that may be applied in determining income deemed to be derived or expenditure deemed to be incurred for any financial arrangements or classes of financial arrangements;
(f) Whether, and in what circumstances, any alternative methods may be used to determine income or expenditure under a financial arrangement or class of financial arrangements;
(g) Whether a method meets the consistency requirements of s EW 24 and when the requirement to use a method for financial reporting purposes may be waived;
(h) Whether or not a method of accounting for income and expenditure under a financial arrangement may be changed and any conditions to be imposed;
(i) Where an excepted financial arrangement is included in a financial arrangement, the method to be used to determine the portion of the income or expenditure that is solely attributable to the excepted financial arrangement;
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(j) The method for determining the discounted value of hire purchase payments payable under any finance lease or hire purchase agreement;

(k) The method for determining the consideration to be taken into account in the case of a disposition between members of the same consolidated group of companies; and

(l) The exchange rate that may be adopted and the circumstances in which that rate may be adopted by a taxpayer or a class of taxpayers, having regard to the costs that would be incurred by the taxpayer or class of taxpayer in otherwise adopting a rate.

The information required for applications is set out in reg 3(1) of the Income Tax (Determinations) Regulations 1987. The applicant must provide:

(a) Fees as may be prescribed;

(b) A draft determination in the form as required by the Schedule to the regulations;

(c) The name or description of the applicant for the determination;

(d) If the applicant requires anonymity, a draft of an anonymous version of the determination;

(e) Copies of relevant documents; and

(f) Written submission and particulars to assist understanding.

The fees are non-refundable, GST inclusive, and include an application fee and a processing fee.

Applications can be made to:
Office of the Chief Tax Counsel,
Inland Revenue Department,
PO Box 2198,
Wellington.

The applications are registered by the CIR who may then make a determination or refuse the application. The CIR prepares a draft determination and the applicant has 10 working days after a date fixed by the CIR to notify a wish to hold a conference on the draft. The conference, if requested, must be within 20 days of the 10-day period, but the CIR may in any event determine to hold the conference.

Determinations can be issued without a conference where it is substantially in accordance with the draft submitted by the applicant, where the applicant waives the right to a conference, and where the CIR independently makes a determination incorporating the matter for which an application was made.

Determinations can be challenged under the disputes resolution procedures.

The CIR can vary, rescind, restrict, or extend a determination by making a fresh determination. Financial arrangements acquired or issued prior to notification or publication of that fresh determination are not subject to it until the expiry of four years.

A person who applies a determination must be assessed accordingly, except where legislation is repealed or amended to that person’s detriment, or there was a material misrepresentation or omission (whether intentional or not) in the application for the determination. A determination is deemed made when signed by the CIR.

470.105 Determinations issued

Many of the determinations currently on issue were formulated under s 90 of the TAA which applies to Division 1 financial arrangements. However, they continue to apply in principle until such time as a fresh determination is issued under s 90AC of the TAA.

The current determinations issued are listed below.

(1) G1A: Apportionment of income and expenditure on a daily basis

Determination G1A allows for the income derived or expenditure incurred by a holder or issuer of a financial arrangement to be apportioned on a straight-line basis. The income or expenditure is apportioned among the income years of the holder or the issuer in which that period falls on the basis of the number of days in the...
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period lying within each income year. The calculation may be made (at the option of the holder or issuer) on either a 360- or 365-day basis. Note that the terms “holder” and “issuer” apply to Division 1 financial arrangements. Division 2 refers only to “parties” to a financial arrangement.

(2) **G2: Requirements as to precision**

Under Determination G2, a calculation is sufficiently precise if the income derived or expenditure incurred from a financial arrangement in any period allocated would not be changed by more than five dollars by the use of greater precision in all intermediate calculations. It provides that calculations must be carried to a sufficient number of decimal places so that going to one further decimal place will not change the result by more than five dollars. It applies to all calculations required by the financial arrangements regime. Accordingly, taxpayers are obliged to comply with it even if they are making calculations pursuant to another determination.

(3) **G3: Yield to maturity method**

Determination G3 applies to the class of financial arrangements that has the following attributes:

(a) All amounts payable or receivable under the financial arrangement, and the dates on which the amounts are payable or receivable, are known not later than the first balance date of the issuer or holder following the date of issue or acquisition as the case may be; and

(b) All such amounts are determined in New Zealand currency. It does not apply to any financial arrangement for which the annual yield to maturity rate determined would be not unique, less than 0 per cent, or greater than 100 per cent.

(4) **G4: Unit trusts with repurchase obligations**

Determination G4 states that the gain or loss arising from the disposal of an interest in a unit trust is solely attributable to the interest in the unit trust.

(5) **G5C: Mandatory conversion convertible notes**

Determination G5C treats all amounts for a note as relating to the underlying shares with the exception of the coupon interest payments. Income and expenditure is calculated on a pro rata daily apportionment of coupon interest to the income years.

(6) **G6D: Foreign currency rates**

Determination G6D applies where it is necessary to ascertain the value in New Zealand currency of:

(a) A cashflow paid or received in a foreign currency;

(b) A financial arrangement denominated in a foreign currency;

(c) In other circumstances, an amount expressed in foreign currency.

(7) **G7C: New Zealand futures and options market**

Determination G7C sets approved markets, sources of information, and methods used in determining prices in the futures market.

(8) **G9A: Financial arrangement denominated in a foreign currency or foreign commodity**

Determination G9A sets out a method for calculating the income and expenditure for a financial arrangement where the rights are expressed in a base currency other than New Zealand dollars. The base currency may be a foreign currency or a commodity [see also Determination G9C].

(9) **G9C: Financial arrangements denominated in a currency other than New Zealand dollars: an expected value approach**

Determination G9C may be used as an alternative to Determination G9A in some circumstances. It applies to financial arrangements where the rights and obligations of the parties are expressed in a base currency (which may be a foreign currency or commodity) other than New Zealand dollars. The determination can be
used only if the payment dates are known on or before the first balance date following the issue of the financial arrangement and if the forward rates for the base currency can be determined. Using this method, the expected component of income or expenditure is spread over the term of the financial arrangement on a daily basis, while the unexpected component is recognised on realisation [see TIB vol 16:5 (June 2004)].

(10) **G10B: Present value calculation methods**

Determination G10B specifies two approved methods of calculating present values for use in other determinations. One method is a general purpose method which gives very similar results to Determination G3, and may be used on either a 360- or 365-day period.

The second method is to calculate prices of government or local authority stock and is similar to the formula approved by the International Association of Bond Dealers and used in calculators such as the HP12C. It differs from the first method in that coupons must be payable at regular half yearly or quarterly intervals, and compound interest is used in the first period, unless it is also the last period in which case simple daily interest is used. The first method always uses simple daily interest in the first period [see TIB vol 2:4 (November 1990)].

(11) **G11A: Accrual income and expenditure using present value based yield to maturity method**

Determination G11A is an alternative to Determination G3. In general there is no explicit formula for a yield to maturity in terms of the cash flows. The yield to maturity is defined as the interest rate at which the present value of all amounts payable after the date of issue or acquisition is equal to the amount payable on that date [see TIB vol 2:4 (November 1990)].

(12) **G12: Accounting for a financial arrangement in the absence of a determination**

Determination G12 applies where it is not possible to calculate income or expenditure using the yield to maturity method, and no determination provides a method of accounting and the amount is not reported for financial reporting purposes.

(13) **G13A: Prices or yields**

Determination G13A applies where it is necessary to determine a price or yield for valuation purposes. It may arise where a market valuation method is required for calculating the amount of income derived from New Zealand Government Stock in an income year. Alternatively, there may be no relevant quotations available. This determination provides approval for markets, sources of information, selection of buy-selling price and approving methods of determining income and expenditure [see TIB vol 2:4 (November 1990)].

(14) **G14: Forward contracts for foreign exchange and commodities**

Determination G14 determines the value of forward contracts where market value is not applied. The contract is divided into two components being the premium (difference between spot and forward rate at commencement) and the change in spot. The premium is spread over the term of the contract and the spot movement accrued [see also Determination G14B].

(15) **G14B: Forward contracts for foreign exchange and commodities: an expected value approach**

Determination G14B can be used as an alternative to Determination G14. It applies to financial arrangements which are forward contracts for foreign exchange or commodities. Using this method, the expected component of income or expenditure is spread over the term of the financial arrangement on a daily basis, while the unexpected component is recognised on realisation [see TIB vol 16:5 (June 2004)].

(16) **G15: Exemption for small debtors**

Determination G15 exempts compliance where three months or less interest is prepaid at the year’s end, and the person is either the issuer of the arrangement or a cash basis holder and total liabilities for financial arrangements for income tax assessing purposes at year end is $200,000 or less.
(17) **G16A: Discounted value of accounts payable for trade credits denominated in New Zealand currency**

Determination G16A provides the method to be used to calculate the core acquisition price of non-short-term trade credits denominated in New Zealand currency, where the terms of the trade credit is known at the commencement and the amounts and dates payable are known on the first balance date after supply. The cash flows are then discounted to present values. It could be used, for example, when a trade credit is entered into on 1 December, under which goods supplied on the following 17 February and to be paid by 14 July. The term of the trade credit (the period from the day after supply date to final payment date) is therefore 147 days [see TIB vol 1:9 (March 1990)].

(18) **G17B: Discounted value of amounts payable for deferred property settlements denominated in New Zealand currency**

Determination G17B applies to deferred property settlements for other than short-term agreements where they are stated in New Zealand dollars, the terms of credit are known at commencement and the amount and dates of payment are known by the first balance date after transfer [see TIB vol 1:9 (March 1990)].

(19) **G19: Exchange traded option contracts**

Determination G19 is for calculating the value of options traded on the exchange with reference to other determinations [see TIB vol 1:9 (March 1990)].

(20) **G20: Discounted value of amounts payable for trade credits denominated in a foreign currency**

Determination G20 provides the method to calculate the core acquisition price for a trade credit where, generally, any right or obligation of the parties is expressed in a base currency other than New Zealand dollars, and all amounts and dates of payment are known at the first balance date after the supply date [see TIB vol 1:9 (March 1990)].

(21) **G21: Discounted value of amounts payable for deferred property settlements denominated in a foreign currency**

Determination G21 applies to any agreement for the sale and purchase of property and to any specified option held or issued by a person, where payments are expressed in a base currency other than New Zealand dollars. It does not apply to any deferred settlement where the amounts payable are denominated in New Zealand currency, or to any deferred property settlement where more than 20 per cent of all the amounts payable is due before 31 days prior to transfer date, or any amount payable or the date of payment or the terms are not known at the first balance date of the person after the transfer date [see TIB vol 1:9 (March 1990)].

(22) **Determination G21A: Agreements for sale and purchase of property denominated in foreign currency: discounted value of amounts payable**

Determination G21 applies to any agreement for the sale and purchase of property (ASAP) which is subject to the accrual rules if the price for the property is denominated in a foreign currency (a foreign currency ASAP), and certain other conditions are met. It does not apply to a short-term ASAP or a private or domestic ASAP as those agreements are excepted financial arrangements [see TIB vol 8:4 (September 1996)].

Determination G21A differs from Determination G21 by:

(a) Removing the option to discount future amounts payable under a foreign currency ASAP using a New Zealand dollar interest rate; and

(b) Removing the requirement to convert the discounted value of amounts payable using the spot rate on the rights date.

(23) **G22A: Optional convertible notes denominated in New Zealand dollars**

Determination G22A replaced Determination G22 on 26 September 2006. It gives the methods under the financial arrangements rules for calculating income, expenditure and the base price adjustment in relation to
optional convertible notes that are denominated in New Zealand dollars. It applies in relation to a financial arrangement that is a convertible note which contains either a share warrant that the holder can exercise only on the maturity date or a share warrant that allows the holder to exercise the warrant component during the convertible note’s term:

(a) That a person becomes party to on or after the date of G22A; and

(b) Four years after the date of G22A for financial arrangements that were entered into before the date of G22A, and that currently apply Determination G22, satisfy the criteria of G22A and have not matured within that four-year period.

Special calculations apply where a financial arrangement changes from being taxed in accordance with Determination G22 to being taxed in accordance with Determination G22A. These are explained in detail in TIB vol 22:10 (November 2010) at 90-92.

(24) G23: Specified rate

Determination G23 applies where it is necessary to determine an annual yield or interest rate for valuation purposes. This rate is called the specified rate. The rate may be required where the present value of an amount payable or receivable under a financial arrangement is to be calculated. Such a calculation is necessary in certain cases (eg in Determination G22). This method approves two methods of selecting a specified rate [see TIB vol 2:4 (November 1990)].

(25) G24: Straight-line method

The straight-line method can be applied if the value of all of the financial arrangements held and issued by the taxpayer is below $1 million at all times during the income year in question. There are two ways of applying the straight-line method. The first applies to arrangements where the principal is fixed, and interest, if any, is payable at regular intervals. All finance charges are spread equally to each income year over the term of the arrangement. The second applies to all other financial arrangements (eg loans with reducing principals). The finance charges are spread over the term of the arrangement in proportion to the principal outstanding. Note that, in the legislative provision to which the determination relates, the threshold has been increased to $1.5 million.

(26) G25: Variations in terms of a financial arrangement

Determination G25 requires an adjustment to be made in the year of variation. It results in the total income or expenditure at the end of the year of variation being equal to what it would have been had the timing and details of the variation been known at the date of issue or acquisition.

(27) G26: Variable rate financial arrangements

Determination G26 applies to variable rate financial arrangements where interest is paid at least annually. Any income or expenditure must be accrued. Two alternative methods may be used.

(28) G27: Swaps

Determination G27 applies to interest rate swaps, interest swaps, currency swaps, interest rate and currency swaps, and interest and currency swaps entered into after 19 January 1995. It does not apply to more complex swaps such as commodity swaps, debt-equity swaps, debt-property swaps, swaps involving more than two currencies, or swaps involving the amortisation or accretion of principal. Four methods (A, B, C, and D) are available for calculating income and expenditure. The main method is Method C, which requires each leg of the swap to be treated as a separate loan and for the normal financial arrangements rules to be applied to each of those loans. Method A may be used if the business of the taxpayer involves dealing in swaps or if the swap is a forward or future contract for foreign exchange. Method B may be used if the swap involves a forward contract for the exchange of currencies. Method D enables the use of any alternative method to Method C provided it has regard to the principles of accrual accounting, conforms with commercially acceptable practice, is consistently applied, and the amounts are not materially different from those calculated under Method C [see TIB vol 6:8 (January 1995)].
Financial Arrangements

(29) **G29: Agreements for sale and purchase of property denominated in foreign currency: exchange rate to determine the acquisition price and method for spreading income and expenditure**

Determination G29 approves the adoption of three alternative exchange rates for converting the foreign currency lowest price into New Zealand dollars. It also prescribes the method that must be used to calculate income or expenditure from a foreign currency agreement for sale and purchase of property.

(30) **G30: Debt securities, finance leases and hire purchase agreements denominated in New Zealand dollars**

Determination G30 allowed persons in the business of lending money to continue to apply the same tax treatment for interest income and expenditure as under the previous rules following their adoption of International Financial Reporting Standards. It was a temporary measure while a legislative solution was being developed. This determination has been withdrawn from use with effect from 1 October 2009.

(31) **S16: Financial arrangement income or expenditure from certain retirement village arrangement**

Determination S 16 relates to occupation right agreements between the operator of the retirement village and the resident. Under such an arrangement, the resident pays the operator the “initial fee”. An accommodation payment accrues daily with the annual fee being seven per cent of the initial fee. The accommodation payment can ever accrue to 35 per cent of the initial fee. There is also a “village expenses payment” which is payable by the resident each month. This is to cover the costs of such things as maintenance, rates, utilities, wages etc. When the agreement is terminated, the operator makes a “termination payment” to the resident or the resident’s estate. This is equal to the initial fee. The agreement consists of both a financial arrangement, being the initial fee and the termination payment, and an excepted financial arrangement, being the accommodation payment and the village expenses payment. The determination does not provide a spreading methodology. The determination, including examples, can be found in TIB vol 22:7 (August 2010).

470.110 **Financial arrangements rules — decision process**

In order for the financial arrangements rules to apply, the taxpayer must be a party to a financial arrangement which is not an excepted financial arrangement. For most financial arrangements, it is necessary to spread the income and deductions over the life of the arrangement with a wash-up calculation (called the base price adjustment) being performed in the year in which the arrangement matures. There are a number of spreading methods that can be used under particular circumstances, although the IFRS and yield-to-maturity method are the most commonly used.

The following flowchart illustrates the process to be followed in determining whether a financial arrangement is involved in a transaction.
The following flowchart illustrates which spreading method to use.

**Spreading Methods**

- Are you required under s EW 15I to use the yield to maturity method? (YTM method) or an alternative method under s EW 16 and EW 19?  
  - Yes: You must use YTM or an alternative method under s EW 15I and EW 19.  
  - No: Do you use IFRS for financial reporting purposes?  
    - Yes: You must use one of the 4 methods described in s EW 15C(1).  
    - No: Are you required under s EW 15H to use a particular determination?  
      - Yes: You must use that determination.  
      - No: Are you required under s EW 15I to use the yield to maturity method?  
        - Yes: You must use yield to maturity.  
        - No: Do you use IFRS for financial reporting purposes?  
          - Yes: You may use SL.  
          - No: Can you use the straight line (SL) method under s EW 17?  
            - Yes: You may use SL.  
            - No: Can you use the yield to maturity (YTM) method under s EW 16?  
              - Yes: You may use MV.  
              - No: Can you use the market valuation (MV) method under s EW 18?  
                - Yes: You may use MV.  
                - No: Is there a determination?  
                  - Yes: You must use a method that complies with s EW 22.  
                  - No: Do you meet the criteria under s EW 22?  
                    - Yes: You must apply to the Commissioner for a determination under s 97AC TAA 1994.  
                    - No: You must use a method that complies with s EW 22.
Chapter 480

Financial Relief

480.10 General position

The CIR has the power to release a taxpayer from a tax liability (tax write off), if that would put the taxpayer in serious hardship, or to allow a taxpayer to defer or spread the payment of a tax liability (instalment arrangement), provided certain conditions are met.

In providing financial relief, the CIR has an overriding statutory duty to maximise the outstanding tax recovered from a taxpayer. However, the CIR may not recover outstanding tax if that recovery is an inefficient use of the CIR’s resources or if it would place a natural person taxpayer in serious hardship [TAA, s 176].

A special form of tax relief is available to farmers who receive new start grants [see 430.105].

Monthly incremental late payment penalties are not imposed on any debt covered by an instalment arrangement, provided the taxpayer adheres to the terms of the arrangement. However, use-of-money interest (UOMI) continues to accrue during the term of the arrangement [see 1110.290].

The CIR may remit UOMI if an emergency event physically prevents a taxpayer from making a tax payment on or before the due date [see 1110.342].

The financial relief provisions apply to all taxes, but not to child support or student loans.

The CIR has issued standard practice statements on instalment arrangements [see 480.35], and writing-off tax debt [see 480.45].

Note: Taxpayers who are having difficulty paying tax that is due, or who expect to have difficulty meeting future tax obligations, should contact Inland Revenue as soon as possible. An early request for tax relief is important because:

(a) Some or all of the debt may be written-off if the taxpayer is facing serious hardship;

(b) Incremental late payment penalties are put on hold for the term of an instalment arrangement and so the debt does not escalate (however, interest is still charged on the outstanding debt);

(c) The taxpayer is able to pay off the debt in a manageable way without getting into serious financial difficulty; and

(d) The mental stress on the taxpayer is reduced.

480.20 Application for financial relief [TAA, s 177]

A taxpayer, or a person on the taxpayer’s behalf, may apply for financial relief by:

(a) Making a claim stating why recovery of outstanding tax would place the taxpayer in serious hardship (ie requesting debt write off); or

(b) Requesting to enter into an instalment arrangement with the CIR.
The application may be made either by telephone or in writing, although the CIR may require that a request under (a) be made in writing.

Upon receiving a request, the CIR may do any of the following:

(a) Accept the taxpayer’s request;
(b) Seek further information from the taxpayer;
(c) Make a counter offer; or
(d) Decline the taxpayer’s request.

If the CIR requests further information or makes a counter offer, the taxpayer has 20 working days to respond. If a taxpayer takes longer than 20 days to respond, the response is treated as a new request for financial relief. The CIR may allow more than 20 days if the taxpayer is having difficulty obtaining the required information or responding to the counter offer [see 480.35].

The CIR will not commence recovery action during the negotiation period. If recovery action has already commenced when the taxpayer seeks financial relief, the CIR will discuss with the taxpayer whether this action will continue during the negotiation period [see TIB vol 14:11 (November 2002) at 84].

In McLean v Commissioner of Inland Revenue (2005) 22 NZTC 19,231 (HC) the High Court dismissed an application by the taxpayer for judicial review of the CIR’s decision not to grant relief under s 177 of the TAA on the grounds of serious hardship and financial difficulty. The CIR had rejected a settlement offer by the taxpayer because the taxpayer had participated in a tax avoidance arrangement and had taken steps to alienate his property and transfer it to trusts. The High Court held that there was no basis upon which the CIR’s decisions could be said to have been unreasonable or a breach of a legitimate expectation. The taxpayer had engaged in transactions, designed to reduce his assets, with two trusts of which he was the sole beneficiary. The taxpayer had transferred property to the trusts when he knew that schemes in which he had invested were being investigated by Inland Revenue and during the period after he had already sought relief.

480.25 Definition of serious hardship [TAA, s 177A]

Serious hardship, for the purposes of financial relief, can apply only in respect of an individual. Serious hardship means significant financial difficulties that arise because of:

(a) The taxpayer’s inability to meet minimum living expenses, according to normal community standards;
(b) The cost of medical treatment for an illness or injury of the taxpayer or their dependant;
(c) A serious illness suffered by the taxpayer or their dependant; or
(d) The cost of education for the taxpayer’s dependant.

Serious hardship does not include significant financial difficulties that arise because:

(a) The taxpayer is obligated to pay tax;
(b) The taxpayer may become bankrupt;
(c) The taxpayer’s, or their dependant’s, social activities and entertainment may be limited; or
(d) The taxpayer is unable to afford goods or services that are expensive or of a high quality or standard according to normal community standards.

The CIR may take into account whether the recovery of outstanding tax from a company would place in serious hardship:

(a) A shareholder who owns 50 per cent or more of the shares in a company;
(b) Two shareholders who jointly own 50 per cent or more of the shares in a company; or
(c) A shareholder-employee of a close company [see 170.05 for the definition of “close company”].

The correct approach when considering whether to grant relief on the basis of serious hardship is to determine whether, in the year in which the tax obligation arose, the taxpayer was able to meet minimum living standards according to normal community standards. The scheme and purpose of the hardship provisions of the TAA...
indicates that the focus should be on the ability of the taxpayer to pay at the time when the tax became payable, not when enforcement proceedings are taken. This is supported by the fact that in s 177A(1)(b)(i) of the TAA, serious financial difficulties do not include difficulties that arise because of the obligation to pay tax: Larmer v Commissioner of Inland Revenue (2010) 24 NZTC 24,016 (HC).

480.30 Instalment arrangements [TAA, s 177B]

The CIR must not enter into an instalment arrangement with a taxpayer if that arrangement would place the taxpayer in serious hardship. The amount of the instalments must therefore take into account the ability of the taxpayer to pay.

The CIR may decline to enter into an instalment arrangement if:

(a) It would not maximise the recovery of outstanding tax from the taxpayer;
(b) The CIR considers that the taxpayer is in a position to pay all of the outstanding tax immediately (eg if a taxpayer has term deposits or other investments, or the ability to borrow sufficient funds to pay the outstanding tax);
(c) The taxpayer is being frivolous or vexatious; or
(d) The taxpayer has not met their obligations under a previous instalment arrangement.

A taxpayer may renegotiate an instalment arrangement at any time. The CIR may renegotiate an instalment arrangement at any time after the end of two years from the date the original arrangement was entered into (ie the date it was accepted by the CIR). The renegotiation of an instalment arrangement is treated as if it were a new request for financial relief.

The CIR may cancel an instalment arrangement if it was entered into on the basis of false or misleading information provided by the taxpayer, or if the taxpayer is not meeting their obligations under the arrangement.

A taxpayer who is meeting their obligations under an instalment arrangement, and who has a refundable tax credit remaining for a tax year, may choose to have the credit paid to them rather than used under the ordering rules in s LA 6(2) and former s LH 2(6).

480.35 CIR’s practice on instalment arrangements

Standard practice statement SPS 11/01 [TIB vol 23:2 (March 2011) at 4–16] sets out Inland Revenue’s practice when considering applications for financial relief by way of an instalment arrangement under s 177 of the TAA. It applies to applications for relief by way of instalment arrangements made on or after 16 February 2011. SPS 11/02 replaces SPS 05/11 [TIB vol 17:10 (December 2005)].

Taxpayers are encouraged to contact the CIR at the earliest opportunity if they think they will have trouble paying their tax by the due date. Options for payment can be discussed, which may include an instalment arrangement if they are unable to pay their tax in full.

Negotiation of an instalment arrangement will generally not commence until the returns relevant to the period have been filed. This is because the outstanding tax needs to be quantified before the CIR will commence negotiation.

Upon receipt of a taxpayer’s application for an instalment arrangement, the CIR has four options:

• Accept the taxpayer’s request;
• Seek further information from the taxpayer;
• Make a counter offer; or
• Decline the request.

The CIR will take into account the following factors when considering a taxpayer’s application for an instalment arrangement:

• Whether the tax payable can be quantified;
• Whether the proposal will place the taxpayer, being a natural person, in serious hardship or cause
financial difficulties for other taxpayer entities;
• Whether the instalment arrangement would maximise the recovery of tax debt from the taxpayer;
• Whether the taxpayer is in a position to pay all of the tax debt immediately;
• Whether the taxpayer is being frivolous or vexatious;
• Whether the taxpayer has met their obligations under a previous instalment arrangement;
• Whether the taxpayer’s proposal is realistic;
• Whether the taxpayer is likely to comply with their current and future tax obligations;
• Whether the taxpayer has filed all relevant returns for the period of the instalment arrangement requested;
• Other relevant factors that the CIR may consider appropriate.

When considering a taxpayer’s application for an instalment arrangement, if the CIR requires further
information the taxpayer has 20 working days (or a longer period where allowed by the CIR) to provide the
information requested. The taxpayer must provide the information requested within the required timeframe,
or request further time from the CIR, to preserve the application for an instalment arrangement. Failure to
provide the information requested is likely to result in the expiry of the negotiation period and lapse of the
application. This means that the initial late payment penalty and the monthly incremental late payment penalty
will be imposed on their tax debt.

When the CIR accepts an instalment arrangement or, the taxpayer accepts a counter offer, the confirmation
will include the terms and set out both the taxpayer’s and the CIR’s obligations under the instalment
arrangement. Confirmation may be made by telephone or electronic means consistent with the method used
by the taxpayer for their application. For a complex instalment arrangement the CIR is likely to set out the
details of the instalment arrangement in writing.

Where the taxpayer applies for an instalment arrangement before the tax is due for payment and the CIR
accepts the application, the initial late payment penalty of one per cent will be imposed on the tax debt.
Regardless of the CIR accepting an instalment arrangement, use-of-money interest will accrue daily on the
tax debt while it remains unpaid.

Where the taxpayer applies for an instalment arrangement after the tax is due and the CIR accepts the
application, the initial late payment penalty of one per cent and, if applicable, the initial four per cent will be
imposed on the tax debt. In addition, any incremental late payment penalties imposed up to the date of the
taxpayer’s request are also payable. Use-of-money interest will also accrue daily on the tax debt that remains
unpaid.

The taxpayer may renegotiate an instalment arrangement at any time. The CIR may do so only after the end
of two years from the date on which the instalment arrangement was entered into. However, the CIR may
cancel an instalment arrangement if it was entered into on the basis of false or misleading information. In
these cases, the late payment penalties will be imposed as if the instalment arrangement had not been entered
into.

Default on payment of an instalment may not undo an overall instalment arrangement. When the CIR is
satisfied a taxpayer is making their best effort to meet their obligations, the terms of an instalment arrangement
may be varied for recovery of the tax debt.

480.40 Write-off of tax by the CIR [TAA, s 177C]
The CIR is authorised to write off outstanding tax that cannot be recovered. The CIR must write off
outstanding tax that cannot be recovered due to bankruptcy, liquidation or the distribution of a taxpayer’s
estate.
The CIR may not write off outstanding tax (including any shortfall penalties) if the taxpayer is liable to pay a shortfall penalty for taking an abusive tax position [TAA, s 141D(2), see 1110.105], evasion [TAA, s 141E(1), see 1110.110], or a similar act in relation to that outstanding tax [see 1110.235].

The CIR may reinstate all or part of any outstanding tax written off if, by operation of law, the CIR receives additional funds in respect of a taxpayer after the taxpayer becomes bankrupt, is liquidated, or if additional funds due to the taxpayer’s estate are discovered after the taxpayer’s estate has been distributed.

If the CIR writes off outstanding tax for a taxpayer who has a net loss, the CIR must extinguish all or part of the net loss by dividing the amount written off by 33 per cent and reducing the net loss by that amount. The taxpayer’s net loss is measured according to the return of income for the tax year preceding the tax year in which the outstanding tax is written off.

**Example:**

A taxpayer has a net loss of $10,000. The CIR is unable to recover outstanding tax of $2,500 due from the taxpayer and writes it off. The taxpayer’s net loss must be reduced by $7,576 ($2,500 / 0.33). This effectively means that the net loss is “cashed in” to pay the outstanding tax.

The CIR has the discretion to write off outstanding tax that results from the payment or crediting of excess abating WFF tax credits or minimum family tax credits in the 2008-2009 tax year. This applies if the tax is outstanding as a result of amendments to the family scheme made by the Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Act 2008. If the amount of outstanding tax is $100 or less, write-off is automatic (TAA, s 177C(1B), (1C)).

The CIR must write off outstanding tax of up to $30 to the extent that it is outstanding from the 2010-2011 tax year and is tax payable under ss MF 5(2) or MF 6(2), or is otherwise the result of WFF tax credit overpayment or overcrediting [TAA, s 177C(1D)].

If the CIR writes off outstanding tax for a taxpayer who has unused imputation credits carried forward, the CIR must extinguish the credits on a one-for-one basis up to the amount of the tax written-off. If a taxpayer has both a net loss and unused imputation credits carried forward, the CIR must extinguish the net loss before extinguishing any unused imputation credits.

The CIR may reinstate outstanding tax written off if:

(a) The outstanding tax was written-off on the grounds of serious hardship and the taxpayer declares bankruptcy, or is subject to bankruptcy proceedings brought by a creditor, within a year of the write off;

(b) The outstanding tax was written off on the grounds of serious hardship and the taxpayer, being a company, is or is in the course of being liquidated within a year of the write-off; or

(c) The outstanding tax was written off due to false or misleading information provided by the taxpayer.

If the CIR enters into an instalment arrangement that provides for some of the outstanding tax to be written off, the CIR may not reverse the write-off even if, during the term of the arrangement, the taxpayer fails to meet some or all of the terms of the arrangement.

The net loss that may be extinguished is the taxpayer’s net loss at the time the outstanding tax is written off. For this purpose, the CIR may use a figure for the net loss based on the most recent tax return filed by the taxpayer.

### 480.45 CIR’s practice on debt write off [TAA, ss 6(1), 6A and 176(1)]

Standard practice statement SPS 06/02 sets out the CIR’s practice for permanently writing-off outstanding tax [see TIB vol 18:5 (June 2006) at 55-64]. The statement applies to all write offs of outstanding tax from 10 May 2006. It replaces SPS RDC-620SPS RDC-620 [see TIB vol 14:11 (November 2002) at 88-93 and TIB vol 15:3 (March 2003) at 5]. SPS 06/02 does not apply to child support, domestic maintenance, or student loan repayment obligations. However, the statement does apply to employer obligations to deduct child support or domestic maintenance from the wages of employees and pay it to Inland Revenue. The statutory rules relating to writing-off outstanding tax are set out in 480.40.
Taxpayers may apply for debt write off by telephone, facsimile, secure Inland Revenue email (Online Correspondence Service) or letter. If Inland Revenue requires the application to be in writing (eg because detailed evidence is required), taxpayers can apply in writing by:
(a) Delivering the notice in person to Inland Revenue;
(b) Sending the notice by facsimile;
(c) Sending an email by secure Inland Revenue email; or
(d) Sending the notice by post.

Applications for debt write off should explain why recovery would place the taxpayer in serious hardship [see 480.25 for definition], and should include supporting financial information. Written applications will not be required when it is obvious from information already available to Inland Revenue that recovery would place the taxpayer in serious hardship. To assess whether the taxpayer would be placed in serious hardship Inland Revenue will request relevant details of the person’s financial position, including typically (but not limited to):

(a) Income and expenditure;
(b) Assets and liabilities;
(c) A 12-month cash flow projection;
(d) Asset valuations;
(e) Statement of financial performance (where applicable);
(f) Statement of financial position (where applicable);
(g) List of debtors and creditors (where applicable).

Upon receipt of a taxpayer’s application for writing-off outstanding tax, Inland Revenue may accept the taxpayer’s request, seek further information from the taxpayer, make a counter offer, or decline the request. Inland Revenue will take into account the following factors when considering a taxpayer’s application for a write off of outstanding tax:
(a) Whether the proposal will place the taxpayer, being a natural person, in serious hardship;
(b) Whether the value of the taxpayer’s proposal when compared to other options would maximise the recovery of outstanding tax from the taxpayer;
(c) Whether the taxpayer is in a position to pay all or part of the outstanding tax immediately;
(d) Whether the taxpayer has filed all required returns; and
(e) Whether other relevant factors exist.

Example 1:
A taxpayer has outstanding tax of $8,000 and has been putting funds aside to clear this amount by the due date. However, at the due date they have only managed to save $2,000 towards this amount. Due to the taxpayer’s financial circumstances, any payment over and above the $2,000 they have saved would cause difficulty in meeting their day-to-day living expenses. Inland Revenue accepts the lump sum payment of $2,000 and writes off the balance on the grounds of serious hardship as it is not feasible for Inland Revenue to enter into an instalment arrangement for payment of the outstanding $6,000.

When considering a taxpayer’s application, Inland Revenue may require the taxpayer to provide additional information within 20 working days (or such longer period that may be allowed). This may include financial information and will include the filing of any outstanding returns. Taxpayers must provide the required information within the allowed timeframe. Information received outside the allowed timeframe will be treated as a new request for financial relief. If Inland Revenue subsequently declines to grant financial relief to the taxpayer, both initial and incremental late payment penalties will be imposed and interest will accrue as if the request for financial relief had not been made.

Although Inland Revenue is required to maximise the recovery of outstanding tax from taxpayers [TAA, s 176(1)], this duty is subject to the overriding obligations to protect the integrity of the tax system [TAA, s 6] and to collect over time the highest net revenue that is practicable within the law [TAA, s 6A].
Example 2:
A taxpayer has outstanding tax of $100,000 and makes an offer of $75,000 to settle the arrears over a period of three years. Inland Revenue considers that bankruptcy would only yield $50,000 and that there are no other viable avenues for recovery. In this instance, Inland Revenue would consider writing-off $25,000 and entering into an instalment arrangement over three years for $75,000. Inland Revenue may permanently write-off outstanding tax under s 174AA(a) of the TAA where the balance of the tax payable is not more than $20. In exercising this discretion Inland Revenue may consider the factors referred to in SPS 06/02.

Inland Revenue will not write off outstanding tax (including any shortfall penalties) if the taxpayer is liable to pay a shortfall penalty for taking an abusive tax position [see 1110.105], evasion [see 1110.110], or a similar act in relation to that outstanding tax [see 1110.235].

Example 3:
A taxpayer has outstanding GST for the 31 March 20X1 return period and also has outstanding income tax for the 20X1 tax year, including a shortfall penalty for taking an abusive tax position. In this instance, where the criteria for serious hardship are met, the outstanding GST can be written-off. However, the outstanding income tax will not be written-off, regardless of whether recovery will cause serious hardship.

Example 4:
A close company owes outstanding tax of $300,000 and its only asset is a debit balance in the principal shareholder’s current account of $300,000. If the company were placed into liquidation, the $300,000 in the current account would be called up. The shareholder’s personal assets are a house valued at $290,000 and a car valued at $7,000. Inland Revenue recognises that any action taken to liquidate this company could place the shareholder in serious hardship. The company agrees to pay to Inland Revenue the sum of $220,000, borrowed against the principal shareholder’s home. The balance of the outstanding tax ($80,000) will be written-off, as collection of the amount would cause the shareholder serious hardship.

Neither a trust nor its trustees can apply for outstanding tax to be written-off on the grounds of serious hardship. Serious hardship applies to natural persons only and the CIR generally considers that a trustee of a trust is not acting as a natural person in that capacity. However, Inland Revenue may consider writing-off a trust’s outstanding tax under s 177C(1) of the TAA if that tax cannot be recovered. In determining whether a trust’s outstanding tax is irrecoverable, Inland Revenue will also consider whether the trustees can satisfy the outstanding tax in their capacity as trustees or personally. If Inland Revenue cannot recover the outstanding tax from the trust or its trustees, the outstanding tax will be considered as irrecoverable for the purposes of s 177C(1) of the TAA.

When writing-off outstanding tax, Inland Revenue must extinguish all or part of any net losses carried forward from the taxpayer’s most recent income tax return and/or any excess imputation credits. Where the taxpayer has both net losses and excess imputation credits carried forward from a previous year, the net losses will be extinguished first.

A taxpayer must file all earlier outstanding tax returns before their applications for a write off of outstanding tax will be considered. Any available net losses and/or excess imputation credits will not be extinguished under s 177C(5) and (5B) until all outstanding tax returns are filed. Inland Revenue may then calculate the net losses using the taxpayer’s most recently filed income tax returns. When Inland Revenue writes off outstanding tax, the taxpayer will be notified in writing of the financial relief granted and of the remaining value of any net losses or excess imputation credits carried forward.

There is no statutory right to challenge or object to any decision of Inland Revenue to grant or cancel relief [s 138E(1)(e)(iv)]. However, if a taxpayer does not agree with Inland Revenue’s decision not to grant relief, the taxpayer may request that the decision be reviewed by the officer involved or their superior officer. The decision may also be reviewed by the Ombudsman or by way of judicial review.
480.50 Late payment penalties when financial relief sought [TAA, ss 139B, 139BA]

The late payment penalty consists of an initial late payment penalty of five per cent of the unpaid tax and an incremental late payment penalty of one per cent of the amount outstanding at the end of each subsequent month. The initial late payment penalty is imposed in two parts: a one per cent penalty imposed on the day after the due date; and a further four per cent penalty imposed at the end of the seventh day after the due date if the tax owing remains outstanding at that time [see 1110.40].

If a taxpayer contacts the CIR seeking financial relief before the date outstanding tax is due, the CIR must impose the one per cent initial late payment penalty, but not the four per cent penalty.

If a taxpayer contacts the CIR seeking financial relief on or after the date outstanding tax is due, the CIR must impose the whole of the initial late payment penalty (ie both the one per cent and the four per cent parts), but must not impose an incremental late payment penalty as from the date of request. The incremental late payment penalty will be imposed from the due date until the date the taxpayer requests financial relief.

“Outstanding tax” is defined, for the purposes of the financial relief rules, as tax that is payable before or after a due date [TAA, s 3(1)]. This definition ensures that taxpayers can enter into an instalment arrangement before the tax is actually due.

If the CIR decides not to give financial relief, or the taxpayer does not provide information sought by the CIR or respond to a counter offer within the response period (20 working days), the late payment penalty (both initial and incremental) is imposed as if no request for relief had been made.

When an instalment arrangement is entered into, the incremental late payment penalty is not imposed for any month during which the taxpayer fully complies with their obligations under the arrangement. Failure to meet any monthly payment obligations means that the incremental late payment penalty will be imposed for that month based on the balance outstanding under the instalment arrangement.

Note: The agreed instalment arrangement amount is the minimum amount that is due each month. Payments in excess of the minimum amount are not used as credits against future monthly obligations. Instead, the additional amount will reduce the total debt. Thus, if a taxpayer who is required to pay monthly instalments of $500 pays $700 during a month, the taxpayer is still required to pay $500 in the following month. However, the total debt will be reduced by the additional payment of $200.

If an instalment arrangement is cancelled on the basis of false or misleading information provided by the taxpayer, the CIR must impose those late payment penalties not imposed, as if the instalment arrangement had not been entered into.

Use-of-money interest continues to accumulate on the outstanding debt until it is paid off [see 1110.290 and TIB vol 14:11 (November 2002) at 87-88].

480.60 Proof of debt [TAA, s 177CA]

If a taxpayer has entered into an instalment arrangement with the CIR and the taxpayer becomes bankrupt or, in the case of a company, is in the course of being liquidated, any amount outstanding under the instalment arrangement must be included in the Inland Revenue’s proof of debt.
Chapter 500

Fishing Industry

500.10 Payments to fishing industry employees

People working on fishing boats are assumed to be employees unless they can substantiate a claim to self-employment. The general rules for determining whether a person is an employee or an independent contractor are set out in TIB vol 11:2 (February 1999) at 5-8. These revised interpretation guidelines were issued following the Court of Appeal decision in TNT Worldwide Express (New Zealand) Ltd v Cunningham [1993] 3 NZLR 681, (1993) 15 NZTC 10,234 (CA) in relation to the employment status of courier drivers [see 335.20].

PIB 125 (March 1984) sets out the rules for determining when such a person is self-employed for income tax and ACC purposes. While these were issued prior to the revised general rules, the two are consistent in policy terms. The tests for self-employed status are:

(a) The operation is carried out under a share fishing agreement;
(b) There is no sick leave entitlement;
(c) There is no right to paid leave of any form;
(d) The costs of operating the fishing boat for the trip are deducted from the gross catch; and
(e) The net amount is shared between the:
   (i) Boat owner, from which overhead expenses are met; and
   (ii) Crew (in varying proportions), from which individual costs are met.

Withholding tax at 20 per cent should be deducted from payments made under these agreements.

Where members of a crew receive a regular wage or a regular wage plus a share of profits, tax deductions must be made according to the appropriate tables for salary and wages. The share of profits should be treated as a bonus and included in gross earnings or, if the share is paid annually, treated as an extra pay. Where crew working on oyster boats are paid on the basis of the number of sacks of oysters obtained, the remuneration is subject to tax deductions as wages.

500.20 Repairs to fishing boats [s EJ 2]

A taxpayer carrying on a fishing business in New Zealand may spread expenditure incurred in making repairs or alterations to the hull, equipment, or machinery of any fishing boat as is required by Part 10 of the Maritime Transport Act 1994. To qualify, the fishing boat must be used wholly and exclusively for fishing. “Fishing boat” means a boat that is registered as a fishing boat under Part 4 of the Fisheries Act 1983; and includes a small boat belonging to any boat that is so registered. A “fishing business” means a business of catching or taking fish, including crustaceans and shellfish for the purpose of sale. The taxpayer may allocate the whole or any part of the expenditure to the income year in which the expenditure was incurred or to any one or more of the four succeeding income years.

If the taxpayer ceases to carry on the fishing business before the end of the fourth tax year following the tax year in which the expenditure was incurred, any expenditure not already deducted may be either:

(a) Deducted in the income year in which the person ceases business; or
(b) Allocated equally to the income year in which it was incurred and the following income years during which the person continued to carry on the business.

**TaxNote:** A “tax year” is the year from 1 April to 31 March while an “income year” is the year ending on balance date of a taxpayer who has a non-standard balance date. The reference to the cessation of business refers to a cessation that occurs before the end of the fourth tax year following the tax year in which the expenditure was incurred. The provision, therefore, applies where the business ceases before 31 March, rather than before the taxpayer’s balance date in any particular year.

### 500.30 Aquaculture deduction for capital expenditure [s DO 12]

Taxpayers carrying on an aquaculture business in New Zealand may claim an amortisation deduction on specified capital expenditure at the rates set out in sch 20, Part B to Part F, applied to the “diminished value” of the asset. For the purposes of this provision, “aquaculture business” is fish farming under a licence issued under the Freshwater Farming Regulations 1983 or farming of mussels, rock oysters, scallops and sea-cage salmon.

In order for the deduction to be claimed, all of the following tests must be met in relation to the expenditure:

(a) The expenditure is incurred on making an improvement of a type listed in the schedule;
(b) It is incurred in the 1995-1996 or later income year, but not in the income year in which the person ceases to carry on the business;
(c) It is incurred in developing the business;
(d) It is of benefit to the business in the income year in which the deduction is allowed;
(e) Where the taxpayer owns the improvement, the expenditure is incurred either by the taxpayer or by some other person; and
(f) Where the taxpayer does not own the improvement, the expenditure in incurred by the taxpayer.

The amount of the allowable depreciation deduction for each income year is calculated using the following formula:

\[
\text{Schedule 20 percentage} \times \text{diminished value of the improvement}
\]

Details of the percentages contained in sch 20, Part B to Part F, are as follows:

<table>
<thead>
<tr>
<th>Diminished value</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Freshwater Fish Farming — Part B</td>
<td></td>
</tr>
<tr>
<td>(a) Drilling of water bores.</td>
<td>6%</td>
</tr>
<tr>
<td>(b) The draining of land or the excavating of sites for ponds, races or tanks.</td>
<td>6%</td>
</tr>
<tr>
<td>(c) The construction of ponds, races, settling ponds, sluices or tanks of impervious materials to conduct and contain water.</td>
<td>6%</td>
</tr>
<tr>
<td>(d) The supply and installation of pipes for water reticulation.</td>
<td>6%</td>
</tr>
<tr>
<td>(e) The construction of access paths, embankments, service paths, walkways or walls.</td>
<td>6%</td>
</tr>
<tr>
<td>(f) The construction of effluent ponds.</td>
<td>6%</td>
</tr>
<tr>
<td>(g) The supply and installation of baffles or screens for the containing or excluding of fish.</td>
<td>12%</td>
</tr>
<tr>
<td>(h) The construction of fencing on the fish farm.</td>
<td>12%</td>
</tr>
<tr>
<td>Mussel Farming — Part C</td>
<td></td>
</tr>
<tr>
<td>The deduction covers expenditure incurred on:</td>
<td></td>
</tr>
<tr>
<td>(a) The acquisition, preparation, and mooring of pontoons, rafts, or other floating structures for collecting spat.</td>
<td>24%</td>
</tr>
</tbody>
</table>
(b) The acquisition, mooring, and outfitting of moored floating platforms or longlines from which the collected spat is suspended for subsequent growth. 24%

(c) The collecting and depositing of shell or other suitable material on the sea bed to create spatting surfaces. 24%

Rock Oyster Farming — Part D

(a) Acquisition and preparation of spatting sticks. 24%

(b) Construction and erection of posts, rails, or other structures for the holding of spatting sticks during spat catching and maturing. 24%

(c) The construction of fences (including breakwater fences). 24%

Scallop Farming — Part E

(a) The acquisition, preparation, and mooring of floating structures for collecting spat. 24%

(b) The acquisition, mooring, and outfitting of longlines from which the collected spat is suspended for subsequent growth. 24%

Sea-Cage Salmon Farming — Part F

(a) The acquisition, preparation, and mooring of floating structures for securing or protecting cages. 24%

(b) The acquisition, preparation, and placing of equipment or structures for containment of live salmon. 24%

(c) The acquisition and placing of ropes and buoys used in breeding or maturing salmon. 24%

Where an improvement which would otherwise qualify for a deduction under s DO 12 is destroyed or irreparably damaged rendering it useless for the purpose of deriving income, the remaining value of the improvement may be written off. In order to qualify for the deduction, the damage must not have been caused by the action or inaction of the taxpayer, an agent of the taxpayer or an associated person of the taxpayer. The provision applies from the 2005-2006 tax year.

Income equalisation scheme

Taxpayers in the business of fishing, rock oyster farming, mussel farming, or freshwater fish farming can make deposits under the farm income equalisation scheme [see 440 FARMERS INCOME EQUALISATION SCHEME].

Acquisition and conversion of transferable term fishing quota

TIB vol 12:3 (March 2000) sets out the CIR’s interpretation of how the cost of a transferable term fishing quota (“TTQ”) under the ITA 1976 is to be treated for income tax purposes. These quota were introduced under the ITA 1976, and have a term life of 25 years. In summary, the cost of a TTQ is not an allowable deduction as the expenditure is capital in nature. However, as TTQ is depreciable intangible property, an allowable deduction for depreciation arises. The conversion of a TTQ to an individual term quota is not considered to be a disposal for the purpose of the depreciation regime [see TIB vol 12:3 (March 2000) at 8, 250 DEPRECIATION].
Chapter 520
Forestry and Timber

520.05 Overview
The forestry tax regime is based on the concept that a forest is a crop rather than trading stock. The amount derived from the sale of cut timber, less a deduction for the cost of the timber, is subject to tax.

As a forest matures, various planting and maintenance expenses are allowed as deductions. These expenses are not included in the cost of the timber sold.

Dispositions of timber rights are also included in the forestry taxation regime.

520.10 Taxation of timber sales
The proceeds of a disposition of timber, or of a right to take timber, constitute income for tax purposes. This is so whether or not the timber is situated on land owned by the taxpayer. A “right to take timber” is defined as including “an easement or licence or right of taking profits or produce from the land to the extent to which the easement, licence, or right relates to timber”.

Where a taxpayer disposes of land on which there is standing timber, the proceeds of the disposition are taxable to the extent to which they relate to the timber. Excluded from this treatment is standing timber which consists of:

(a) Ornamental or incidental trees;
(b) Trees subject to a forestry right as defined in the Forestry Rights Registration Act 1983; and
(c) Trees subject to a right to take a benefit in the form of a profit à prendre granted before 1 January 1984.

The fact of whether or not trees are incidental or ornamental must be evidenced by a certificate issued by an officer of the Ministry of Forestry or by some other person suitably qualified to give such a certificate.

Where it is necessary to separate the value of the timber from the value of the land, two cases provide some guidance.

In Rusk v Commissioner of Inland Revenue (1986) 8 NZTC 5,128 (HC), Henry J adopted an “added value” approach to the valuation of the land and timber. He held that the correct approach was to value the land first and then to value the timber by reference to the added value which it brings to the land. He considered that this approach was particularly warranted because it was impractical to sell the timber separately from the land. Although the CIR did not appeal this case, it is considered to be limited in application to cases involving the sale of immature timber. In the case of mature timber the valuation method should be adopted. In Tasman Forestry Ltd v Commissioner of Inland Revenue [1999] 3 NZLR 129, (1999) 19 NZTC 15,147 (CA), the Court of Appeal found the cost of land and standing timber distributed in specie during a corporate...
reconstruction can be the value of the cost of the shares in the company from which the land and timber was distributed.

There may be difficulty in determining the actual cost of the timber where the land has been owned for a considerable time. The CIR has stated that, in such cases where the cost is not known, and regardless of the time for which the property has been held, the amount that will be taxable on sale will be the difference between the value of the timber at the time of purchase and the value at the date of sale; this will usually be taken on a royalty basis.

A forestry owner wishing to sell land without losing ownership of the trees can create a forestry right for himself or herself. The creation of such a right does not give rise to a tax liability because the definition of “dispose” (and therefore “disposition”) in s YA 1 specifically excludes a forestry right created for oneself.

Where there is a life tenancy for the income from a stand of timber, such income should be assessed as trustee income. The proceeds of sale are only assessable to the life tenant if the life tenant is entitled in possession to the proceeds in terms of the will.

520.20 Deductible forestry expenditure [ss DP 1, DP 2, DP 3, DP 4]

Some specific deductibility rules apply to a taxpayer who is carrying on a forestry business on land in New Zealand. The definition of “forestry business” includes permanent forest sink initiative forests established under the emissions trading scheme.

The following expenditures incurred by a taxpayer carrying on a forestry business on land in New Zealand are deductible:

(a) Rent, rates, insurance premiums, administrative overheads, or other like expenses;
(b) Weed, pest or disease control, or fertiliser application after planting;
(c) Planting or maintaining trees on the land;
(d) Interest on money borrowed and employed as capital for the purposes of that business;
(e) Repair or maintenance of plant, machinery, or equipment used mainly in planting or maintaining the trees or in preparing or otherwise developing the land for forestry operations;
(f) Repair or maintenance of land improvements (other than trees) which are used mainly in a forestry business;
(g) The construction to or on the land of access tracks that are constructed for a specific operational purpose and are used for no longer than 12 months after construction; and
(h) The cost of standing timber that is lost or destroyed.

The remaining value of any improvement that is destroyed or irreparably damaged rendering it useless for the purpose of deriving income can be written-off under certain circumstances. The circumstances are that:

(a) The damage does not result from the action or failure to act of the taxpayer, the taxpayer’s agent or an associated person of the taxpayer; and
(b) The taxpayer would otherwise have been allowed a deduction in respect of that improvement under s DP 3. The provision has application for the 2005-2006 and subsequent income years [s DP 4].

Any expenditure which is recouped by way of insurance or otherwise is required to be included in income in the income year in which it is recouped.

Section DP 2 provides a deduction for depreciation of plant or machinery acquired and used after 1 April 1975 where that plant or machinery is used primarily and principally in planting or maintaining trees on land in New Zealand on which the person carries on a forestry business or in preparing or developing land for forestry operations.

Any expenditure which is allowable as a deduction is not to be included in the cost of timber [see 520.30].
520.30 **Deduction for cost of timber expenditure** [s DP 10, DP 11]

The “cost of timber” determines the amount of the deduction that is available at the time at which the timber is sold.

First, what is timber? It is defined for the purposes of s DP 11 as including:

(a) The creation or grant of a right to take timber;
(b) The grant of a licence or easement in relation to timber;
(c) The creation of a “forestry right”, other than a right in favour of the proprietor, in relation to establishing, maintaining and harvesting timber.

“Forestry right” is defined in the Forestry Rights Registration Act 1983.

The “cost of timber” means the amount of expenditure incurred in relation to timber at the following time:

(a) Before harvest where harvested timber is being disposed of; and
(b) Before disposal of the timber or of a right referred to in the definition of “timber”.

It includes, for the purposes of s DP 11, expenditure on planning, planting and growing timber.

The following amounts are not included in “cost of timber”:

(a) Deductible expenditure;
(b) Expenditure incurred in avoiding, remedying, or mitigating the effects of a discharge of contaminants to which s DB 46 applies; and
(c) Expenditure which is deductible under s DQ 4 as a transfer to an environmental restoration account.

The amount of the deduction for the “cost of timber” which is available at the time at which the timber is sold varies according to the circumstances.

The cost of timber does include the cost of acquiring an existing forest or forestry right. If the forest or right was acquired by way of an acquisition of land on which there was standing timber, the purchaser’s cost of timber is the amount that was income of the vendor.

Where the forest or forestry right was trading stock of the vendor and was sold together with other assets, the purchaser’s “cost of timber” is the amount determined under s EB 24 [see 1400.70].

Where the forest or forestry right was acquired under a relationship agreement, the purchaser’s “cost of timber” is the amount determined under ss FB 6 and FB 7. These sections provide that the transferee is treated as having acquired the forest or forestry right from the transferor for consideration equal to the transferor’s costs. That amount is treated as income to the transferor and a cost of acquisition to the transferee.

Where the forest or forestry right was acquired for nil or inadequate consideration, the purchaser’s “cost of timber” is the amount determined under s GC 2 [see 880.95].

Where a forest or forestry right was acquired by way of a shareholder distribution from a company, the shareholder’s “cost of timber” is market value under ss FC 1 and FC 2.

Where a forest or forestry right was acquired from an associated person, s DP 10 limits the vendor’s cost of timber deduction to the amount of the income derived on the sale. The purchaser’s cost of timber then becomes the sum of the amount paid to the associated person for the acquisition plus the amount (if any) for which the vendor was denied a deduction.

**Example:**

Alex and Bob are associated persons. Alex purchases a forest for $3 million. Ten years later Alex sells the forest to Bob for $2 million. Alex’s cost of timber deduction is limited to $2 million, being the amount for which the forest was sold to Bob resulting in Alex having neither a profit nor a loss. Bob’s cost of timber is $3 million made up of the $2 million paid to Alex plus the $1 million for which Alex was denied a deduction.

The cost of timber is not necessarily limited to the actual amount paid for the timber or forestry right. It may also include some historic costs. Prior to the 1991-1992 income year, the costs of planting and maintaining
trees were carried forward and allowed as a deduction only when the timber was sold. For some taxpayers there may still be such expenditure being held in the cost of timber account.

A cost of timber account may be maintained on a stand by stand, annual planting or total forest basis. Where not all of the timber to which a cost of timber account relates is felled in one income year, the costs will need to be spread between the timber felled and the timber that remains standing. This generally is done on an area basis.

The timing of the deduction for the cost of timber depends on whether the forest is held as trading stock or as revenue account property. If it is held as trading stock, the deduction is allowed in the income year in which it first becomes trading stock of the taxpayer. Closing stock at year end is required to be brought to account under the trading stock rules. If it is held as revenue account property, the deduction is allowed in the year of sale.

**520.40 Expenditure on forestry land improvements [ss DP 3, DP 4, DZ 18]**

Certain items of capital expenditure are able to be amortised for tax purposes on an annual percentage basis. The deduction is equal to the percentage specified in sch 20, Part G (listed below) of the amount of the diminished value of the expenditure. “Diminished value” means the amount of expenditure reduced by:

(a) The total deductions allowed in any preceding year for that expenditure; and
(b) Any deduction for that expenditure allowed in the current income year under any other section.

(1) **Land owned by taxpayer**

The taxpayer is entitled to an amortisation deduction for expenditure of any of the kinds listed below incurred personally or by any other taxpayer in developing that land and which is of benefit to the business in that income year. The inclusion of expenditure incurred by another taxpayer enables the claiming of unexpired expenditure incurred by a previous owner of the land. The taxpayer claiming the deduction must carry on forestry business on that land.

(2) **Land not owned by taxpayer**

The taxpayer is entitled to an amortisation deduction for expenditure of any of the kinds listed below, incurred by the taxpayer in developing that land and which is of benefit to the business in that income year. The taxpayer claiming the deduction must carry on forestry business on that land.

No deductions are allowed under this provision for expenditure incurred in the income year in which the taxpayer disposes if the land. The deductions are not recoverable where improvements are sold for more than book value. The following rates [see sch 20, Part G] apply to expenditure incurred from the 1995-1996 income years:

<table>
<thead>
<tr>
<th>Expenditure — Part G</th>
<th>Diminished value allowed as deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>The felling, clearing, destruction, or removal of timber, stumps, scrub, or undergrowth on the land in the preparation of the land for the planting of trees on that land.</td>
<td>6%</td>
</tr>
<tr>
<td>The eradication or extermination, to enable the planting of trees on the land, of animal or vegetable pests on the land.</td>
<td>6%</td>
</tr>
<tr>
<td>The destruction, to enable the planting of trees on the land, of weeds or plants detrimental to the land.</td>
<td>6%</td>
</tr>
<tr>
<td>The draining of swamp or low-lying lands in the preparation of the land for the planting of trees on the land.</td>
<td>6%</td>
</tr>
<tr>
<td>The construction of roads to or on the land, being roads which are formed and wholly or substantially metalled or sealed, and any culverts or bridges that are necessary for the purposes of that construction.</td>
<td>6%</td>
</tr>
</tbody>
</table>
**Expenditure — Part G**

<table>
<thead>
<tr>
<th>Diminished value allowed as deduction</th>
<th>24%</th>
</tr>
</thead>
<tbody>
<tr>
<td>The construction of roads to or on the land (including any culverts or bridges that are necessary for the purposes of that construction), being roads which are formed and partially metalled or sealed; or roads which are not metalled or sealed, and not being access tracks for which a deduction may be claimed under s DP 1(1)(h).</td>
<td>24%</td>
</tr>
<tr>
<td>The construction of dams, stopbanks, irrigation or stream diversion channels, or other improvements for the purpose of conserving or conveying water for use on the land or for preventing or combating soil erosion.</td>
<td>6%</td>
</tr>
<tr>
<td>The repair of flood or erosion damage.</td>
<td>6%</td>
</tr>
<tr>
<td>The sinking of bores or wells for the purpose of supplying water for use on the land.</td>
<td>6%</td>
</tr>
<tr>
<td>The construction of aeroplane landing strips to facilitate aerial top-dressing or disease control work for firefighting on the land.</td>
<td>6%</td>
</tr>
<tr>
<td>The construction on the land of fences, including the purchase of wire or wire netting for the purpose of making new or existing fences rabbit proof.</td>
<td>12%</td>
</tr>
<tr>
<td>The erection on the land of electric power lines or telephone lines.</td>
<td>12%</td>
</tr>
</tbody>
</table>

For expenditure incurred before the 1995-1996 income year, the rates are the base rates increased by 25 per cent, rather than the 20 per cent increase which applies to expenditure incurred from the 1995-1996 income year (as outlined above). This means that the five per cent rate is increased to 6.3 per cent (rather than six per cent), the 10 per cent rate to 12.5 per cent (rather than 12 per cent), and the 20 per cent rate to 25 per cent (rather than 24 per cent).

Where any s DP 4 improvement is destroyed or irreparably damaged, rendering it useless for the purposes of deriving income, the remaining value of the improvement is able to be written-off provided that the taxpayer would otherwise have been entitled to a deduction under s DP 3 in respect of that asset in that income year. The damage must not have been caused by the action or inaction of the taxpayer, an agent of the taxpayer or an associated person of the taxpayer [s DP 4].

### 520.50 Joint venture of holding company, Maori owners, and the Crown

[ss CW 1, CW 3, DP 9]

Special provisions apply where a forestry business is carried on by a forestry company as a joint venture by the Crown, Maori owners, and a holding company.

Interest payable under any debentures issued by the forestry company for unpaid purchase money for land purchased from any of the partners in the joint venture, or for money lent to it by a holding company for development purposes, is exempt from income tax. Interest payable under any debentures issued by a Maori investment company (ie a company holding on behalf of Maori owners shares or debentures issued by the forestry company) is similarly exempt from income tax provided that it is capitalised by way of the issue of further debentures. Where such interest is exempt, no deduction is allowable to the forestry company or Maori investment company for that interest.

A sale to the forestry company by any of the partners in the joint venture of land together with any standing timber thereon is deemed not to be a sale of the timber. The cost of the timber to the forestry company is not to exceed the cost of the timber to the person by whom the land was sold to the company.

“Forestry company” means a company that is incorporated under an agreement between the Crown, the Maori owners, and a holding company of the company for the purposes of buying land partly from the Crown, partly from the Maori owners and partly from a holding company of the forestry company and carrying on a forestry business on that land.
520.51  **Treaty of Waitangi claim settlements** [ss CW 1B, DP 9B, DP 11]

Special rules apply where a person’s right to take timber is extinguished and new rights to take timber are granted in their place. In order for the special rules to apply, the following conditions must be satisfied:

(a)  The sole reason for the replacement is to facilitate a Treaty of Waitangi claim settlement process; and

(b)  The rights and obligations of the new rights are equivalent to the old rights, other than for differences that are solely to facilitate the settlement.

Where these conditions are met, any income that would otherwise arise from the disposal of the old right is exempt income. However, the exemption does not extend to any amount paid to the person as compensation for accepting the new right in exchange for the old.

The new rights are deemed to have been acquired for a cost equal to the expenditure which was incurred on the old right. This applies only in so far as that expenditure relates to the land covered by the new right and to the extent to which it has not previously been allowed as a deduction. Where the person is entitled to the exempt income treatment, the deemed cost of the new right does not give rise to any deduction under the cost of timber rules.

520.55  **Deceased estates** [s FC 6]

Where timber, standing timber or a right to take timber is transferred on the death of the owner to a “close relative”, the transfer is treated as a settlement of relationship property for the purposes of Subpart FB [see 960.90]. The treatment applies not only to a direct transfer, but also to a transfer on death to the executor, administrator or trustee and the subsequent transfer to the beneficiary.

A “close relative” is a surviving spouse or a person within the second degree of relationship to the deceased.

520.60  **Spreading of forestry income** [ss EI 1, EJ 1]

The income from the sale or other disposition of timber or the right to take timber can be spread at the option of the taxpayer over the income year of derivation and up to three preceding income years.

A written application must be made to the CIR not later than one year following the end of income year of derivation. The taxpayer may specify the amount of income that is to be allocated to each income year.

Where the taxpayer elects to use the income spreading provision, deductions for the cost of timber must also be allocated to each of the relevant income years on the same proportional basis.

520.70  **Forestry income equalisation scheme**

New Zealand forestry companies may deposit in a special income equalisation scheme reserve account the proceeds from thinning operations [see 440.65].
Chapter 530

Franchises, Licences and Trade Ties

530.10 Franchises and licences

Whether amounts derived from the sale of franchises and licences are assessable or deductible is a question of fact.

In Commissioner of Taxation v Merv Brown Pty Ltd (1985) 16 ATR 218, 85 ATC 4,080 (FCA), the sale of rights by a clothing wholesaler to share in base import quotas (comprising three per cent of its total entitlements) was a capital sum, because it was a sale of an essential part of the taxpayer’s income earning mechanism.

In Trailways Motel Systems of New Zealand Ltd v Commissioner of Inland Revenue (1976) 2 NZTC 61,097 (SC), money received from sales of franchises was held assessable as sales of “know-how” derived as part of the business carried on by the franchise vendor. The franchisee gained an entitlement to establish a motel in a specified area using a licensed trade name and, in return, the vendor agreed to subscribe for shares in a company established by the franchisee.

In Kwikspan Purlin System Pty Ltd v Commissioner of Taxation (1984) 15 ATR 531, 84 ATC 4,282 (QSC), the taxpayer sold the exclusive right to use an invention to several companies in a certain specified area. The lump sum payment received for each sale was held to be a capital receipt upon realisation of an asset.

In TRA Case S71 (1996) 17 NZTC 7,441, the purchaser of a mobile video library franchise was able to deduct a portion of the franchise fee relating to an all-weather-uniform and stationery.

(1) Lotto franchise

The retailer with a lotto sales outlet must pay to the New Zealand Lotteries Commission a franchise fee, and also pays ongoing expenditure such as line hire charges, terminal maintenance service charges, and entry coupon and sales ticket costs. The franchise fee is a capital expense and not deductible to the retailer. The ongoing expenditure is revenue related and deductible.

530.20 Trade ties

(1) Inducement payments paid by oil companies to petrol retailers

The deregulation of the oil industry has resulted in an increase in trade-tie agreements between oil companies and petrol retailers. Each agreement is considered on its own merits. The following is generally the income tax position:

(a) Regular cash payments: income.
(b) Regular credits or rebates: income.
(c) Single lump-sum payment: may not be income, depending on the facts.
(d) Payments either to the retailer or a third party for improvements or extensions to retailer’s premises: not income.
(e) Agency rights: not income.

(2) Development allowance paid to petrol station owners

In BP Australia Ltd v Federal Commissioner of Taxation [1966] AC 224, (1965) 112 CLR 386, (1965) 9 AITR 615 (PC), the appellant company, in order to counter a similar move by one of its competitors, joined with three other oil companies to secure filling stations where their products might in common be resold to
the public, and through this arrangement the appellant agreed to pay a “development allowance” as part of the consideration for the undertaking by the proprietor of the service station to deal exclusively, for a specified number of years, in the brands of motor spirit approved by the appellant. The gallonage factor was a matter for consideration in deciding what sum should be the maximum amount paid in a particular case, but it was not the determining factor.

The Privy Council, on appeal from the majority judgment of the High Court of Australia, held:

(a) The guiding features to be considered in this class of case were:

(i) The character of the advantage sought, ie how long it would last, the question of recurrence and the nature of the need for expenditure;
(ii) The manner in which the advantage was to be used;
(iii) The means adopted to obtain the advantage; and

(b) The advantage sought by the expenditure was to promote sales and orders by up-to-date marketing methods, and orders were obtained in the circumstances only from tied retailers;

(c) The agreements with the retailers were part of the appellant company’s ordinary selling process; and

(d) The expenditure was of a revenue nature, and was therefore allowable.

In Maney and Sons De Luxe Service Station Ltd v Commissioner of Inland Revenue [1967] NZLR 41 (SC), where quarterly payments receivable for an exclusive “trade tie” to a particular oil product were assessable income. The reasons include:

(a) The payments were small and regular and not a substantial sum agreed in advance;
(b) The tie period was not substantial;
(c) No goodwill loss was suffered;
(d) There had been no calculation of any capitalisation of lost profits over the relevant period; and
(e) Payments were not used for capital improvements to property.

In Birkdale Service Station Ltd v Commissioner of Inland Revenue (1999) 19 NZTC 15,493 (HC), the High Court found that payments made to retail petrol station operators as trade-tie arrangements that anticipated and secured compliance with petrol supply agreements were income in nature. The Court found that the payments were made to enable the retailers to carry out their business under an arrangement that best suited them, and was not made under a restraint of trade arrangement. The amounts were therefore required to be included in gross income. The taxpayer’s appeal to the Court of Appeal was unsuccessful: Birkdale Service Station Ltd v Commissioner of Inland Revenue [2001] 1 NZLR 293, (2000) 19 NZTC 15,981 (CA).
Chapter 540
Fringe Benefit Tax

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Fringe Benefit Tax

540.10  **Imposition of fringe benefit tax** [ss RA 5, RD 26]

Fringe benefit tax (FBT) in New Zealand is not governed by its own statute, but is dealt with under the Income Tax Act 2007. This is in contrast to the Australian fringe benefits tax, which has its own legislative basis (The Fringe Benefits Tax Act 1986 and The Fringe Benefits Tax Assessment Act 1986). Despite the difference in legislative approach, New Zealand’s FBT has many features in common with its Australian counterpart. Australia’s FBT was introduced on 1 July 1986, only 15 months after New Zealand’s (1 April 1985), and many of the similarities are the result of mutual consultation and common design objectives.

The legislation provides that an employer who provides a fringe benefit to an employee must pay FBT in accordance with the “FBT rules” [ss RD 25, RD 26]. The FBT rules are defined in s RD 25, as ss CX 2 to CX 38, GA 2, GB 31, GB 32, RD 26 to RD 63, sch 1 (part C), sch 5 of the ITA; and ss 46B to 46E, 93, Part 7 and 139B of the TAA.

Under the FBT rules, an employer who provides or grants a fringe benefit to an employee is liable to pay FBT [s RD 26]. The liability for FBT is imposed on employers rather than employees for two main reasons:

(a)  The Government hopes that by imposing the liability on employers, they will be discouraged from providing non-cash benefits; and

(b)  Because it is administratively more efficient to collect the tax from employers than from each individual employee.

The flowchart below illustrates when a particular benefit is subject to FBT. It is a general approach only and must be used in conjunction with the legislation.

540.15  **Meaning of fringe benefit** [ss CX 2, CX 6, CX 9, CX 10, CX 12, CX 13, CX 14, CX 15, CX 16, CX 37]

A fringe benefit is a benefit provided by an employer to an employee, in connection with their employment, that consists of:

(a)  The making available of a motor vehicle to an employee for their private use, whether the vehicle is owned, leased or rented by the person who makes it available [s CX 6(1)].
Fringe Benefit Tax

(b) Subsidised transport [s CX 9].

c) A loan provided by an employer to an employee [s CX 10(1)]. However, a FBT liability will arise only if the rate of interest on the loan is less that the “prescribed” rate.

d) Travel, accommodation, attendances and communications services provided to members of Parliament, where the services are exempt income under s CW 31 [s CX 12].

e) A non-monetary contribution by an employer to a superannuation scheme for the benefit of an employee [s CX 13]. Monetary contributions are subject to specified superannuation contribution withholding tax [see 540.105].

(f) A contribution by an employer to a sickness, accident or death benefit fund for the benefit of an employee [s CX 14].

g) A contribution by an employer to a funeral trust [s CX 15].

(h) A payment by an employer of a specified insurance premium, or a contribution by an employer to the insurance fund of a friendly society, for the benefit of an employee [s CX 16].

(i) An unclassified benefit [ss CX 2(1)(b)(ii), CX 37]. This includes free, subsidised or discounted goods and services.

In each case, in order to constitute a fringe benefit, the benefit must have been provided to the employee in connection with their employment. The above benefits are explained in more detail in subsequent paragraphs.

Inland Revenue’s policy is that the mere availability for private use or enjoyment of any employee benefit (other than a motor vehicle) will not constitute a fringe benefit subject to FBT. A benefit which is not a motor vehicle and is provided by the employer will only be a fringe benefit if the employee has actually used, enjoyed, or received the benefit in relation to, in the course of, or by virtue of the employee’s employment [see TIB vol 6:10 (March 1995) at 3].

**Example:**

A television rental company makes television sets and video recorders available to its employees for their private use. FBT is only payable on any day on which an employee takes the equipment home and uses it privately. The value of the fringe benefit is based on the market value of the benefit (ie the amount the company would have charged a customer for that use).

**540.20 Employment relationship [s CX 2]**

The liability to pay FBT is dependent on the existence of an employment relationship. A benefit is not a fringe benefit for FBT purposes unless it is provided by an employer (or, by another person under an arrangement with the employer) to an employee “in connection with their employment”.

**Example 1:**

Jim works full-time in his father’s motorcycle repair shop. His father, who operates his business as a sole trader, gives Jim a motorbike for his 21st birthday. Although Jim is an employee of his father, no FBT liability arises because the gift was not given to Jim by virtue of the employment relationship but rather out of natural love and affection for a family member. If Jim’s father operated his business as a company, instead of as a sole trader, the provision of the free motorbike to Jim would still not be subject to FBT. However, it would constitute a dividend because company property is distributed for less than market value to an associated person of a shareholder.

**Example 2:**

Jim purchases a set of motorcycle leathers from his father’s business at 20 per cent below cost. The same discount is available to all employees. In this case an FBT liability arises because the benefit was provided because of the employment relationship.

**Note:** In addition to fringe benefits provided by employers directly to current employees, the following are also subject to FBT:

(a) Fringe benefits provided to employees who have not yet commenced working for the employer;

(b) Fringe benefits provided to former employees;

(c) Fringe benefits provided to associated persons of employees [see 540.35];
Fringe Benefit Tax

(d) Fringe benefits provided to employees by third parties with whom the employer has entered into an arrangement [see 540.45]; and
(e) In the case of subsidised transport, fringe benefits provided to employees by a company in the same group of companies as the employer [see 540.125].

540.25 Meaning of employee [s YA 1]

An “employee” is a person who is entitled to receive PAYE income payment [s YA 1]. A fringe benefit arises even if the employment relationship does not exist at the time the employee receives the benefit [s CX 2(3)].

Example:
A fringe benefit is provided by an employer to a former employee (e.g., goods sold at less than cost). Where the benefit was provided because of the past employment relationship, it will be subject to FBT.

A “PAYE income payment” is a payment of salary or wages, an extra pay, or a schedular payment [s RD 3, see 1080.10]. Individuals who receive only the following kinds of PAYE income payments are not employees for FBT purposes:

(a) Accident compensation earnings-related payments;
(b) Deductible payments made by partnerships to working partners under s DC 4;
(c) Payments of income-tested benefits, veteran’s pensions, New Zealand superannuation, or living alone payments;
(d) Basic grants and independent circumstances grants made under the Education Act 1989;
(e) Parental leave payments; or
(f) Schedular payments referred to in sch 4, parts A (payments to non-resident contractors) and I (personal service rehabilitation payments) for which the person is liable for income tax under s BB 1 [see paragraph (c) of the definition of “employee” in s YA 1].

In Roma Properties Ltd v Commissioner of Inland Revenue (1998) 18 NZTC 13,903 (CA), the company sold off land and advanced the proceeds as loans to its directors, just before FBT was put into place. The company loans to the directors were recorded in their current accounts. The shareholders and directors changed their status in the company and became managers of the newly-configured company. They continued to have the same duties as before. The Court of Appeal held that the shareholders of a company had passed competent resolutions to pay directors’ fees, and the directors must be taken to have performed their services and provided consideration for payment of directors’ remuneration. The directors were therefore employees for FBT purposes.

540.30 Meaning of employer [s YA 1]

An employer is a person who pays or is liable to pay a PAYE income payment. The following are specifically included in the definition of employer:

(a) The manager or other principal officer of an unincorporated body of persons (other than a partnership);
(b) Each partner in a partnership;
(c) Each person in whom property has become vested or to whom the control of the property has passed in the case of a deceased person, a trust, a company in liquidation or an assigned estate, or where property is vested or controlled in a fiduciary capacity; and
(d) The Crown (including Government departments and local authorities).

A person who only pays PAYE income payments of the types listed as exclusions in 540.25 is not an employer for FBT purposes.
540.35 Fringe benefits for associated persons [ss CX 2(5), CX 18, GB 32, subpart YB]

If an employer provides a fringe benefit to a person who is associated with an employee (such as a spouse [see 960.10] or child), the benefit is taxed in the same way as if it had been provided directly to the employee. This applies whether the benefit is provided by the employer directly or by another person under an arrangement with the employer [ss GB 32, subpart YB].

The most likely situation in which an “associated person” [see 70.20] will receive a fringe benefit is when one is provided to a “relative” [see 70.45] of an employee. For income tax purposes, a “person” includes a company and a partnership, as well as an individual.

If a fringe benefit is provided to a person who is associated both with an employee and with a shareholder, the benefit is deemed to be a fringe benefit subject to FBT if the following conditions are met:

(a) The employer is a company;
(b) The associated person is not a company;
(c) The associated person is not an employee or a shareholder of the company; and
(d) The benefit would be a dividend if provided to a shareholder [ss CX 18, GB 32(4)].

This provision is intended to overcome the uncertainty which arises when a non-cash benefit is provided by a company to a person who is associated with two or more persons, one of whom is an employee and the other a shareholder. An associated person is not deemed to be an employee for the purpose of calculating FBT on attributed and non-attributed fringe benefits [see 540.300 and 540.315].

An FBT liability does not arise when a company provides a benefit to an associated person of a shareholder-employee if:

(a) The associated person is a company; and
(b) The benefit is not provided under an arrangement intended to provide the benefit in place of employment income or free from FBT [s GB 32(2)].

540.45 Fringe benefits from third parties [ss CX 2(2), YA 1]

If an employer enters into an arrangement under which a third person provides a benefit to an employee, the benefit is taxed in the same way as if the employer had provided it directly to the employee [s CX 2(2)]. The employer (and not the person actually providing the benefit) is thus liable for FBT on the benefit.

Bulk discounts arranged for employees by employers through unrelated third parties are exempt from FBT [s CX 33, see 540.200, 540.255].

An “arrangement” is a contract, agreement, plan or understanding (whether enforceable or not), including all steps and transactions by which it is carried into effect [s YA 1]. Inland Revenue considers that an arrangement for the provision of a benefit to an employee by a third party exists where:

(a) Consideration passes from the employer to the third party for a benefit;
(b) The employer requests, instructs or directs the third party to provide a benefit;
(c) There is negotiation or discussion between the employer and the third party which (explicitly or implicitly) involves the threat or suggestion that the employer would withhold business or other benefits from the third party unless a benefit is provided to the employees; or
(d) The third party and the employer are associated parties, and there is a group policy (whether formal or informal) or any other agreement between the associated parties, that employees of the group will be entitled to receive benefits from the other companies in the group.

An arrangement for the provision of a benefit to employees will not exist if the employer has merely facilitated contact between its employees and a third party to enable a benefit to be offered or discussed [see Public ruling BR Pub 09/07, TIB vol 21:7 (September 2009) at 7-21; the ruling applies from the start of the 2008-2009 income year to the end of the 2013-2014 income year].
Example 1:
An employee works for a company. She obtains a personal credit card and joins its associated points reward scheme. Under that scheme she can accumulate points as goods and services are charged on the credit card. After the employee accumulates 10,000 points, she can transfer those points, at her option, to any one of a number of airlines’ frequent flyer schemes affiliated to the credit card company’s points reward scheme. Once she accumulates a specified number of points on the airline frequent flyer scheme, she can exchange them for free or discounted travel.

In the course of her work, the employee incurs a number of employment-related charges on the credit card as well as private expenditure. The employee accumulates points on the credit card points reward scheme for both types of expenditure. She soon reaches the specified threshold of points, and transfers them to a particular airline’s frequent flyer scheme, exchanging them for a free trip to Fiji.

Section CX 2(2) will not apply. The company does not have an FBT liability. The receipt of the points under the credit card company’s points reward scheme is because of the contractual arrangement between the credit card company and the employee. No arrangement exists between the employer and the credit card company to provide the employee with entitlements under its points reward scheme or the associated airline’s frequent flyer scheme. It does not matter that some of the points that give the entitlement result from employment-related expenditure.

Example 2:
DFG, a travel agent, employs a number of staff, and enters into a scheme with YTR, an airline, to strengthen their relationship. The scheme involves YTR agreeing to give a certain number of free domestic flights per year to employees of DFG who excel in promoting and selling YTR flights. In return, DFG agrees to have their employees promote YTR flights, and convert flights to YTR wherever possible. To determine which employees are entitled to free flights, DFG awards its staff with points for outstanding customer service. Once a staff member has accumulated the required number of points, they are entitled to a free flight from YTR. There is no cost to DFG for those flights.

Here, s CX 2(2) will apply. There is an “arrangement” between the parties, as the course of action agreed to between DFG and YTR involves the provision of a benefit to employees. One of the main purposes of DFG in entering into the arrangement is to provide the staff with free flights. Although DFG has another significant purpose in entering into the arrangement, which is to strengthen their relationship, the purpose of providing a benefit to employees is not incidental to that purpose. Therefore, FBT will be payable by DFG on the value of the flights.

540.50 Fringe benefits provided to shareholder-employees [ss CX 17(1), (3), CD 20(4)]

Where a company provides a benefit to an employee who holds shares in the company, the benefit is deemed to have been provided in connection with that person’s employment rather than in their capacity as a shareholder. This applies whether the employee holds the shares in his or her own right, or beneficially on behalf of someone else. The benefit is taxed as if the employee had received it directly in relation to their employment.

A benefit provided by a group investment fund [see 620 GROUP INVESTMENT FUNDS] to an employee who holds an interest as an investor in the fund is also treated as a fringe benefit [s CX 17(1)]. This provision does not apply to a non-cash benefit provided to a shareholder who is a non-executive director [s CX 17(3)]. A non-executive director is a person whose only services to the company as an employee are the formal occupation of the role of director and compliance with the associated statutory obligations [s CD 20(4)].

Example:
A company provides a non-executive director shareholder with a motor vehicle that is available for her private use. The benefit is treated as a taxable non-cash dividend and not as a fringe benefit.

The following table summarises the tax treatment of non-cash benefits provided to various categories of shareholders and employees of companies:

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<td>Yes</td>
<td>Yes</td>
<td>No</td>
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<td>Shareholder-employee</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>
Fringe Benefit Tax

<table>
<thead>
<tr>
<th>Where received by:</th>
<th>Is FBT imposed?</th>
<th>Is it deductible to company?</th>
<th>Is it taxable to recipient?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive director-shareholder</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Non-executive director-shareholder</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Shareholder</td>
<td>No</td>
<td>No</td>
<td>Yes (as a dividend)</td>
</tr>
</tbody>
</table>

Fringe benefits provided to employees who have shares in qualifying companies are subject to FBT whether or not they are derived by the shareholders in their capacity as shareholders. Both the fringe benefit and the FBT are deductible in these circumstances.

Non-monetary benefits provided to non-employee shareholders of qualifying companies are deemed to be non-cash dividends and not fringe benefits. A non-cash dividend (except for a taxable bonus issue) from a qualifying company is exempt because imputation credits and DWP credits cannot be attached to such dividends [ss HA 14 to HA 16]. In either case, as a dividend it is not a deductible expense.

540.55 Election regarding benefits provided to shareholder-employees
[ss CD 20, CX 17(2)-(5)]

A company or a trustee of a group investment fund that has provided a non-cash benefit to an employee who holds shares in the company, or who is an investor in the fund, may choose to treat the benefit as either a fringe benefit or a dividend if the benefit would:

(a) In the absence of s CD 32 (which excludes fringe benefits that are subject to FBT from being dividends), be a dividend under s CD 4 if provided to a person in their capacity as a shareholder; and

(b) In the absence of s CX 4 (which excludes employment-related benefits that are assessable income from being fringe benefits), be an unclassified benefit if provided to a person in their capacity as an employee [s CX 17(2), (4)].

Note: Before the start of the 2008-2009 income year, only one of the above conditions, (a) or (b), had to be satisfied in order for an election to be made. A transitional provision enables a person who took a tax position based on the previous version of s CX 17(4) in the period from 1 April 2008 to 7 September 2010 (the date of Royal assent of the amendment Act) in a return filed before 7 September 2010 to make an election on that basis.

If the company or trustee does not make an election, the benefit is treated as a fringe benefit. If the company or trustee chooses to treat the benefit as a dividend, the FBT rules do not apply.

The election must be in writing and must be delivered to Inland Revenue within the time allowed for filing a FBT return for the period in which the benefit was provided [see 540.325].

A non-cash benefit provided by a company to a non-executive director of the company is treated as a dividend in all cases [see 540.50].

540.60 Motor vehicles [ss CX 6, CX 7, CX 36, YA 1]

A fringe benefit arises when a motor vehicle is made available to an employee for their private use [s CX 6]. This applies whether the person making the vehicle available owns, leases or rents the vehicle, or has a right to use the vehicle under an agreement or arrangement with the employee or a person associated with the employee. The person making the vehicle available may be either the employer or a person with whom the employer has made an arrangement for the benefit to be so provided [s CX 2(2)].

The availability for use or enjoyment of a motor vehicle per se is not a fringe benefit. A fringe benefit only arises if the employer makes the motor vehicle available for use by the employee for private purposes.

“Motor vehicle” is defined as a vehicle drawn or propelled by mechanical power, including a trailer [s 2(1) Land Transport Act 1998]. The definition excludes certain specialised types of vehicle. For FBT purposes, a vehicle with a gross laden weight exceeding 3,500 kg is not a motor vehicle [s YA 1]. “Private use” of a motor vehicle by an employee includes travel in the vehicle to and from work, and any other travel that confers a private benefit on the employee [s CX 36].
(1) Case law

In *TRA Case S26* (1995) 17 NZTC 7,182, the TRA found that it would be “quite unjust to suggest that a company should pay FBT on the basis of a vehicle being available to shareholder-employees when they were permitted to use the vehicle for work purposes only, and complied with that direction, and owned and used their own vehicle for all private motoring”. The company vehicle concerned was a Chevrolet hatchback.

In *Commissioner of Inland Revenue v Schick* (1998) 18 NZTC 13,738 (HC) the use of utilities and a van to transport employees of an earthmoving business between their homes and their place of work was held not to constitute a fringe benefit because the homes were essentially a base of work. The employees were expected to maintain contact with clients and carry out necessary bookwork from home. They travelled directly from their homes to their place of work each day; there was no requirement for them to first go to the main depot. The vehicles were provided to enable the employees to service and operate earthmoving equipment in remote rural areas.

In *Commissioner of Inland Revenue v Yes Accounting Services Ltd* (1999) 19 NZTC 15,296 (HC), the meaning of “availability for private use” in s CX 6(1) was clarified. The respondent company owned a car which was used only for business purposes but was garaged at the home of a shareholder-employee for security reasons. The CIR contended that because the vehicle was garaged at the shareholder-employee’s home, it was available for private use even if it was not, in fact, used for private purposes. The Court held that the wording of the legislation means that a vehicle is only available for private use if that availability is with the permission of the proprietor of the vehicle. In this case the company had written to the shareholder-employee and instructed him that the vehicle was not available for private use. A logbook showed that the vehicle was dedicated to business use. The vehicle was therefore not available for private use within the terms of the legislation. The Court noted that it would have been preferable if the directors of the company had passed a directors’ resolution prohibiting private use of the vehicle and if the shareholder-employees, in their capacity as employees, had acknowledged and agreed in writing to be bound by that direction.

(2) Vehicles leased from employees [s CX 7]

If an employer and an employee enter into an agreement or arrangement transferring the right to use a motor vehicle to the employer (typically, an arrangement under which a shareholder-employee leases a vehicle to a company), the employer is treated as having a right to use the motor vehicle for any period during which the employee:

(a) Uses the vehicle privately, or
(b) Has a right to use the vehicle privately.

The effect of this rule is to eliminate the use of “nine-to-five” and “flip-flop” leases as a means of avoiding liability for FBT [see 540.115]. Section CX 7 achieves this result by treating the period of private use as a period during which a fringe benefit is provided. This provision also applies if an associated person of the employer and/or an associated person of the employee enter into the agreement or arrangement.

540.65 Calculating the value of motor vehicle fringe benefit [ss RD 28, RD 29, RD 30, sch 5]

The value of a motor vehicle fringe benefit depends on whether the employer pays FBT on a:

(a) Quarterly basis;
(b) Annual basis; or
(c) Income year basis [s RD 29].

(1) FBT paid on a quarterly basis

When FBT is paid quarterly, the value of a motor vehicle fringe benefit is calculated using the formula:

\[
\frac{\text{days} \times \text{Schedule 5 amount}}{90}
\]

Where:
“Days” is the number of days in the quarter on which the motor vehicle is made available for private use, reduced by the number of days on which the vehicle was a work-related vehicle (“days” may not exceed 90) [see below];

“Schedule 5 amount” is the value of the benefit that would have been received for unlimited private use of the vehicle in the quarter, as calculated under sch 5 [see 540.90].

(2) **FBT paid on an annual basis**

When FBT is paid on an annual basis the value of the motor vehicle fringe benefit is the aggregate of the amounts calculated for each quarter in the applicable tax year using the method for the quarterly basis.

(3) **FBT paid on an income year basis**

\[(\text{days} \times \text{Schedule 5 amount}) / 365\]

Where:

“Days” is the number of days in the income year on which the vehicle is made available for private use, reduced by the number of days on which the vehicle was a work-related vehicle. The total of “days” may not exceed 90 [see 540.85];

“Schedule 5 amount” is the value of the benefit that would have been received for unlimited private use of the vehicle in the income year, as calculated under sch 5 [see 540.90].

(4) **Option to elect starting time of “day” [s RD 30]**

An employer has the option of choosing the starting time of a day for FBT purposes. The starting time that the employer elects applies to all motor vehicles of the employer that are subject to FBT and must be used for a minimum of two years. The starting time must be a whole number of hours after midnight (eg 11 am, 4 pm or 7 pm, but not 8.30 pm). If an employer does not elect to use a particular starting time, a day is treated as a 24-hour period starting at midnight.

Despite the requirement to use an elected starting time for at least two years, an employer may apply to the CIR to change the starting time for a day, or to treat an election as revoked, if the employer’s circumstances change significantly and make the original starting time no longer relevant to the employer’s business.

**Example:**

An employee finishes work at 6 pm and travels home in his employer’s vehicle. He returns the vehicle at 8 am the next day. If the employer elects a starting time of 6 pm, only one day’s FBT would be incurred on the vehicle.

**540.7 Exempt days [ss CX 6, RD 29]**

The number of days on which the vehicle is made available for private use means the number of days during the quarter or income year on which the motor vehicle was actually available for the private use of an employee. Any days on which the vehicle is not so available will not be included in the value of “days” when calculating the value of the benefit [ss CX 6, RD 29].

**Example 1:**

A motor vehicle is available for an employee to take home each weekday, but not over the weekends. “Days” will be the number of weekdays in the period.

Whether or not a motor vehicle is available for private use on any particular day is a matter of fact. In each case, for a day to be treated as an exempt day, the motor vehicle must not be available for private use at any time during the 24-hour period.

**Example 2:**

A motor vehicle is not available for private use on any days on which the vehicle is:

(a) Parked at an airport car park;
(b) Broken down or being repaired (eg at a garage or panel beater); or
(c) Being stored at the employer’s premises (eg over the weekend).
A motor vehicle is not available for the private use and enjoyment of an employee on any day that the employee uses the vehicle:

(a) To make an emergency call [see 540.75]; or
(b) For out-of-town business travel for a period of at least 24 hours [see 540.80].

540.75 Emergency calls [ss CX 6(3), (5), CX 34]

No fringe benefit arises on any day on which a motor vehicle is used for an emergency call. The whole of the day on which a motor vehicle is used for an emergency call is treated as a day on which the vehicle is not available for private use, even if the vehicle is in fact used privately on that day [s CX 6(3), (5)].

“Day” means a period of 24 hours ending at midnight (unless the employer has elected a different start time).

An “emergency call” is defined as a visit that an employee must make from home in the course of their employment, at the request of their employer, a customer, or a member of the public [s CX 34]. The purpose of the visit must be to perform services that are:

(a) Essential to the operation of any plant or machinery of the employer, or of a client or customer;
(b) Essential to the maintenance of services provided by a public or local authority, or by a business comprising the supply of energy or fuel to the public; or
(c) Emergency services relating to the health or safety of any person.

Except in the case of services that relate to health and safety, the services must be required to be performed between 6 pm and 6 am on any weekday, or at any time on a Saturday, Sunday, or statutory public holiday.

Example:

As part of his duties, a freezing-plant maintenance engineer is required to inspect a client’s large freezing unit each day to ensure that the correct temperature is being maintained. The check is made at noon on each day. On Saturday and Sunday, the engineer travels from his home to conduct the check, using a vehicle provided by his employer. In this case, the maintenance of the correct temperature is essential to the operation of the client’s freezing unit. Therefore, the maintenance engineer’s visits on Saturday and Sunday qualify as emergency calls. Any Saturday, Sunday, or public holiday on which such an inspection visit is made will not be a day on which FBT is payable on the vehicle [see TIB vol 6:9 (February 1995) at 21].

540.80 Business travel [s CX 6(4), (5)]

No fringe benefit arises on any day on which an employee is absent from home, with the motor vehicle, for a period of at least 24 hours continuously. This exclusion applies only if the employee is required to use a vehicle and to be regularly absent from home in the performance of their duties [s CX 6(4)].

The whole of the day on which a motor vehicle is used for a business trip is treated as a day on which the vehicle is not available for private use, even if the vehicle is in fact used privately on that day [s CX 6(5)]. Incidental private use therefore does not affect the exemption. “Day” means a period of 24 hours ending at midnight (unless the employer has elected a different start time).

Example:

A travelling salesman employed by a company makes regular overnight business trips away from home using his employer’s motor vehicle. During a quarter, he was away from home from 2 pm on Tuesday until 6 pm on Friday. As the trip exceeds 24 hours, each day of absence (Tuesday to Friday inclusive) will be treated as a day the vehicle was not available for private use. In this quarter, “days” in the formulae in 540.65 would be reduced by four.

540.85 Work-related vehicle [ss CX 6(2), CX 38, YA 1]

A fringe benefit does not arise when a motor vehicle is a work-related vehicle [s CX 6(2)]. A “work-related vehicle” is a motor vehicle that meets the following conditions:

(a) It is not a car;
(b) The form of identification that the employer regularly uses is prominently and permanently displayed on the exterior of the vehicle;
If the vehicle is rented, the form of identification that the employer regularly uses, or the form of identification that the person from whom the vehicle is rented regularly uses, is prominently and permanently displayed on the exterior of the vehicle; and

The motor vehicle is not available for any private use other than travel to and from the employee’s home, or travel that is incidental to the employee’s employment duties [s CX 38].

A motor vehicle is not a work-related vehicle on any day that it does not meet condition (d).

A “car” is a motor vehicle designed exclusively or mainly to carry people. Car includes motor vehicles that have rear doors or collapsible rear seats (eg station wagons and hatchbacks), but does not include taxicabs, minibuses, motorcycles or mopeds [s YA 1].

A “minibus” is a motor vehicle designed wholly or mainly to carry people, the interior of which contains either:

(a) Three seats, each of which is designed to seat two or more adults, is permanently fixed to the vehicle, and is not collapsible or capable of being folded down; or

(b) More than three seats, at least three of which are designed for seating two or more adults, are permanently fixed to the vehicle, and are not collapsible or capable of being folded down [s YA 1].

The following is a summary of vehicles that can and cannot qualify as work-related vehicles.

**Work-related vehicles**  
**Non-work-related vehicles**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxis</td>
<td>Cars (sedans)</td>
</tr>
<tr>
<td>Minibuses</td>
<td>Station wagons</td>
</tr>
<tr>
<td>Utilities</td>
<td>Hatchbacks</td>
</tr>
<tr>
<td>Light pick-up trucks</td>
<td>4WDs</td>
</tr>
<tr>
<td>Vans</td>
<td></td>
</tr>
<tr>
<td>Station wagons</td>
<td></td>
</tr>
<tr>
<td>Hatchbacks</td>
<td></td>
</tr>
<tr>
<td>4WDs</td>
<td></td>
</tr>
</tbody>
</table>

* If permanently without rear seats (ie the rear seats have either been removed, or welded down, or made unusable by the installation of shelving or the like).

Any vehicle with a gross laden weight exceeding 3,500 kg does not give rise to a fringe benefit.

(1) **Case law**

In *TRA Case J50* (1987) 9 NZTC 1,281 the vehicles of a chauffeur-driven limousine service with discreet non-affixed business cards and vehicle authority stickers did not qualify as work-related vehicles.

In *Tisco Ltd v Commissioner of Inland Revenue* (1991) 13 NZTC 8,049 (HC), it was held that the question of whether or not a vehicle is designed principally for the carriage of persons relates to the vehicle’s construction and not to the owner’s use of the vehicle. If a vehicle is designed equally for passengers and for goods, neither purpose can be called the principal purpose.

In *Commissioner of Inland Revenue v Rag Doll Fashions (New Zealand) Ltd* (1995) 17 NZTC 12,104 (HC), it was held that vehicles which were motorcars (referred to as “cars” in the ITA 2007), when they left the factory may be altered to qualify as work-related vehicles. The vehicles at issue were altered by lowering the back seats and placing plywood covers over them, with the result that they were no longer exclusively and principally designed for the carriage of persons.

**Note:** Inland Revenue have indicated that it had originally appealed the *Rag Doll Fashions* decision but had withdrawn that appeal for reasons peculiar to the case. However, the withdrawal of the appeal should not be taken as acceptance by Inland Revenue that temporary design alterations are sufficient to satisfy the work-
related vehicle test. Inland Revenue’s view is that alterations to the design of a motorcar must be permanent in order to satisfy the test [see TIB vol 7:13 (May 1996) at 19].

**540.90 Value of benefit from motor vehicle [ss RD 29, RD 50, RD 51, RD 56, RD 57, sch 5]**

Determining the value of private benefit from the use of a motor vehicle is calculated using the formulae in s RD 29 [see 540.65]. These formulae use schedular values of benefit located in sch 5, called the “Schedule 5 amount”. An employer has the option of calculating FBT using either the cost price or the tax value of the vehicle [s RD 28(2), sch 5]. The employer chooses which method to use in the first period that FBT is calculated for a vehicle. This method must then continue to be used until the earliest of the following dates:

(a) The date the vehicle is disposed of;
(b) The date the vehicle ceases to be leased by the employer or an associated person without a consecutive or successive lease of the vehicle by the employer or an associated person; or
(c) Five years after the start of the initial FBT period [s RD 28(3)].

After five years, the employer can choose between cost price or tax value for any subsequent FBT period [s RD 28(4)].

An employer must use the cost price valuation method if:

(a) The vehicle is owned, leased or rented by the employer or an associated person; and
(b) The employer or the associated person owned, leased or rented the vehicle before 1 April 2006 [s RD 28(5)].

However, the cost price method does not have to be used if:

(a) The employer’s initial return for the vehicle is for a period beginning on or after 1 April 2006 and the vehicle is not subject to a “nine-to-five” or “flip flop” type lease arrangement under s CX 7 [see 540.60]; or
(b) The vehicle is owned by the employer or an associated person and five years has elapsed since the start of the period of the employer’s first return for the vehicle [s RD 28(6), (7)].

**1) Tax value [sch 5]**

Normally, “tax value” means the adjusted tax value of the vehicle at the beginning of the tax or income year, as determined under the depreciation rules [subpart EE]. In the first income year or tax year that the vehicle is acquired, the tax value of a vehicle is its cost. The tax value of a vehicle cannot be less than $8,333 for FBT purposes.

However, special valuation rules apply if, in the period of two years before the vehicle’s acquisition by the person (person A) providing it to the employee, the vehicle was owned by person A or by a person (person B) associated with them. In these circumstances the tax value of the vehicle for person A is the adjusted tax value of the vehicle at the beginning of the tax or income year, or at the time of acquisition, as determined under the depreciation rules, if the cost of the vehicle were the applicable one of the following:

<table>
<thead>
<tr>
<th>Circumstances</th>
<th>Amount treated as cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>The cost price was last used by person A or person B for calculating the value of the benefit.</td>
<td>The highest cost of the vehicle to person A or person B on any acquisition of it by them.</td>
</tr>
<tr>
<td>Person A did not own the vehicle and person B last used the tax value of the vehicle for calculating the value of the benefit.</td>
<td>The higher of the following amounts:</td>
</tr>
<tr>
<td></td>
<td>(a) The tax value of the vehicle for person B immediately before they last disposed of it;</td>
</tr>
<tr>
<td></td>
<td>(b) The cost of the vehicle to person A on acquisition.</td>
</tr>
</tbody>
</table>
Circumstances

Person A owned the vehicle and the tax value was last used for calculating the value of the benefit.

Amount treated as cost

The higher of the following amounts:

(a) The tax value of the vehicle for whichever of person A or person B last used the tax value of the vehicle for calculating the value of the benefit, immediately before the last disposal;

(b) The cost of the vehicle to person A on the last acquisition of it by them.

The tax value of a vehicle cannot be less than $8,333 for FBT purposes. Thus if the adjusted tax value of a vehicle drops below $8,333, the tax value for FBT purposes is treated as $8,333.

(2) Value of benefit [sch 5]

The value of the benefit (ie the “Schedule 5 amount”) is determined as follows:

<table>
<thead>
<tr>
<th>FBT period</th>
<th>Options</th>
</tr>
</thead>
<tbody>
<tr>
<td>FBT calculated on a quarterly basis</td>
<td>5% of GST-inclusive cost price;</td>
</tr>
<tr>
<td></td>
<td>9% of GST-inclusive tax value;</td>
</tr>
<tr>
<td></td>
<td>5.625% of GST-exclusive cost price; or</td>
</tr>
<tr>
<td></td>
<td>10.125% of GST-exclusive tax value.</td>
</tr>
<tr>
<td>FBT calculated on an annual or income year basis</td>
<td>20% of GST-inclusive cost price;</td>
</tr>
<tr>
<td></td>
<td>36% of GST-inclusive tax value;</td>
</tr>
<tr>
<td></td>
<td>22.5% of GST-exclusive cost price; or</td>
</tr>
<tr>
<td></td>
<td>40.5% of GST-exclusive tax value.</td>
</tr>
</tbody>
</table>

The same valuation options apply whether the vehicle is owned or leased by the person making it available to the employee. If a vehicle is leased, the lessor must disclose to the lessee the cost price or tax value of the vehicle if the lessee requests this information. If there is a pool of vehicles available for private use by one or more employees, the following valuation options apply to a particular vehicle in the pool:

Type of usage

<table>
<thead>
<tr>
<th>Options</th>
</tr>
</thead>
</table>

Vehicle used mainly by one employee

Vehicle not used mainly by one employee

Vehicle not used mainly by one employee, and vehicle is trading stock of an employer in the business of selling motor vehicles

The market value of a leased or rented motor vehicle is used by a person instead of its cost price if the vehicle has previously been leased or rented to another person and:

(a) The person is not associated with the other person;

(b) The person is not associated with the lessor or the owner of the vehicle;

(c) The employee is not the lessor or owner of the vehicle; and

(d) The employee is not associated with the lessor or owner of the vehicle.

Example 1:

An employer purchases a car for $27,000 (including GST) on 1 April 20X1 and makes it available for private use by an employee without restriction. The GST-exclusive cost price of the vehicle is $24,000. The employer calculates FBT on a quarterly basis.
In the FBT period commencing 1 April 20X1, the employer must elect to calculate its FBT liability using either cost price or tax value. The method chosen must be used until the FBT period ending 31 March 20X6. The value of the benefit in the first quarter under each of the valuation options is as follows:

<table>
<thead>
<tr>
<th>Option</th>
<th>Value of benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>GST-inclusive cost price</td>
<td>$27,000 × 5% = $1,350</td>
</tr>
<tr>
<td>GST-inclusive tax value</td>
<td>$27,000 × 9% = $2,430</td>
</tr>
<tr>
<td>GST-exclusive cost price</td>
<td>$24,000 × 5.625% = $1,350</td>
</tr>
<tr>
<td>GST-exclusive tax value</td>
<td>$24,000 × 10.125% = $2,430</td>
</tr>
</tbody>
</table>

If the employer calculated its FBT on an annual or income year basis, the value of the benefit under each of the valuation options is as follows:

<table>
<thead>
<tr>
<th>Option</th>
<th>Value of benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>GST-inclusive cost price</td>
<td>$27,000 × 20% = $5,400</td>
</tr>
<tr>
<td>GST-inclusive tax value</td>
<td>$27,000 × 36% = $9,720</td>
</tr>
<tr>
<td>GST-exclusive cost price</td>
<td>$24,000 × 5.625% = $5,400</td>
</tr>
<tr>
<td>GST-exclusive tax value</td>
<td>$24,000 × 40.5% = $9,720</td>
</tr>
</tbody>
</table>

Under the cost price option, the value of the benefit will be the same for every FBT period for the first five years. Under the tax value option, the value will be higher initially but will decline over subsequent years, as illustrated by the following example.

Example 2:
A motor vehicle costing $54,000 (including GST) is made available for private use by an employee from 1 April 20X1. Depreciation on the vehicle is calculated at 36 per cent DV. The value of the benefit for each of the first five years under the two valuation options is as follows:

<table>
<thead>
<tr>
<th>Year ending 31 March</th>
<th>Cost price including GST</th>
<th>Calculation</th>
<th>Value of benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X2</td>
<td>$54,000</td>
<td>54,000 × 5% × 4</td>
<td>$10,800</td>
</tr>
<tr>
<td>20X3</td>
<td>$54,000</td>
<td>54,000 × 5% × 4</td>
<td>$10,800</td>
</tr>
<tr>
<td>20X4</td>
<td>$54,000</td>
<td>54,000 × 5% × 4</td>
<td>$10,800</td>
</tr>
<tr>
<td>20X5</td>
<td>$54,000</td>
<td>54,000 × 5% × 4</td>
<td>$10,800</td>
</tr>
<tr>
<td>20X6</td>
<td>$54,000</td>
<td>54,000 × 5% × 4</td>
<td>$10,800</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>$54,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year ending 31 March</th>
<th>Tax value including GST</th>
<th>Calculation</th>
<th>Value of benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X2</td>
<td>$54,000</td>
<td>54,000 × 9% × 4</td>
<td>$19,440</td>
</tr>
<tr>
<td>20X3</td>
<td>$34,560</td>
<td>34,560 × 9% × 4</td>
<td>$12,442</td>
</tr>
<tr>
<td>20X4</td>
<td>$22,118</td>
<td>22,118 × 9% × 4</td>
<td>$7,962</td>
</tr>
<tr>
<td>20X5</td>
<td>$14,156</td>
<td>14,156 × 9% × 4</td>
<td>$5,096</td>
</tr>
<tr>
<td>20X6</td>
<td>$9,060</td>
<td>9,060 × 9% × 4</td>
<td>$3,262</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>$48,202</td>
</tr>
</tbody>
</table>

The total value of the benefit over the five-year period is less using the tax value method, although significantly more FBT will be paid in the first two years. For example, applying the 64 per cent FBT rate, $3,710 less FBT would be paid using the tax value option than the cost price option, over the five-year period.

In 20X7, the adjusted tax value of the car will be $5,798 ($9,060 less depreciation at 36 per cent DV). Since the tax value cannot be less than $8,333, the value of the benefit in 20X7 will be $3,000 ($8,333 × 36%). Under the cost price method, the value of the benefit in 20X7 will be $10,800.

540.95 Motor vehicle acquired from associated person [s GB 31, sch 5, cl 4]
When FBT was first introduced, enterprising employers sought to reduce their FBT liability on motor vehicles by selling them to an associated person and then buying them back at a reduced price. This reduced price
would then be used as the basis for calculating the value of the benefit. A specific anti-avoidance provision \[\text{sch 5, cl 4}\] was introduced to eliminate this loophole.

Under this anti-avoidance provision, where a person acquires a motor vehicle that is to be made available for private use by an employee, the cost price of the motor vehicle for FBT purposes is the highest cost price paid for the car since its manufacture by the person or an associated person if, within two years (ie 24 months) preceding the date of acquisition, the motor vehicle has been owned by that person or an associated person.

**Example 1:**
AB and AC are associated persons. AB purchased a new car for $40,000. Eighteen months later AB sold the car to AC for $32,000. For FBT purposes, the cost price of the motor vehicle to AC is $40,000 \[\text{see TIB vol 7:2 (August 1995) at 31}\].

<table>
<thead>
<tr>
<th>Months</th>
<th>AB</th>
<th>AC</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>$40,000</td>
<td></td>
</tr>
<tr>
<td>18</td>
<td></td>
<td>$32,000</td>
</tr>
<tr>
<td>24</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Example 2:**
FG and FH are associated persons. FG purchased a new car for $70,000 and six months later sold the car to FH for $55,000. FH kept the car for 12 months and then sold it to an unrelated third party (XY) for $48,000. Twenty-six months later, FG purchased the car from the unrelated third party for $25,000. For FBT purposes, during the 12-month period of ownership by FH, the cost price of the car is $70,000, because it was owned within the preceding 24 months by an associated person. During the second period of ownership by FG, the cost price of the car will be $25,000. The anti-avoidance provision does not apply in this latter period because the car was not owned by FG or FH during the preceding 24 months.

<table>
<thead>
<tr>
<th>FG</th>
<th>FH</th>
<th>XY</th>
<th>FG</th>
</tr>
</thead>
<tbody>
<tr>
<td>$70,000</td>
<td>$55,000</td>
<td>$48,000</td>
<td>$25,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Months</th>
<th>FG</th>
<th>FH</th>
<th>XY</th>
<th>FG</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td></td>
<td></td>
<td>$48,000</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>$70,000</td>
<td>$55,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>18</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>24</td>
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<td></td>
</tr>
<tr>
<td>44</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Another anti-avoidance provision applies where a motor vehicle is acquired at less than market value, or the cost price is unable to be established \[\text{s GB 31}\]. The cost price of a motor vehicle for FBT purposes is deemed to be its market value at the date of acquisition if:

(a) The motor vehicle was acquired at no cost;

(b) The cost price of the motor vehicle was less than its market value as a result of the purchaser entering into an arrangement with an associated person in order to defeat the intent and application of the FBT rules; or

(c) The purchaser is unable to establish the cost price of the motor vehicle to the satisfaction of the CIR.

### 540.100 Cost price of a motor vehicle

The cost price of a motor vehicle for the purposes of calculating FBT under \text{s CX 6(1)(a)} and \text{sch 5} includes:

(a) The purchase price of the vehicle;

(b) The cost of initial registration and licence plate fees;

(c) The cost of accessories, components and equipment other than business accessories (see below) fitted to the vehicle at the time of purchase or subsequently; and

(d) The cost, including freight insurance costs and customs duty, of transporting the motor vehicle to the place where it is to be first used.

In all cases, the price or cost is the GST-inclusive amount \[\text{sch 5, cl 8}\].

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The cost price of a motor vehicle does not include the cost of:

(a) Annual vehicle re-licensing fees;
(b) Road user charges;
(c) Sign-writing the vehicle in the company’s colours or style (in physical terms, the addition of paint or other graphics such as magnetic signs, decals or transfers);
(d) Business accessories fitted to the motor vehicle at the time of purchase or subsequently; or
(e) Financing the purchase of the vehicle.

(1) Business accessories

Business accessories are accessories, components, and equipment fitted to the vehicle, required for and relating solely to the business operations for which the vehicle is used, and that are depreciable property [see 250.20].

Where business accessories are powered, they will usually require the vehicle’s power source to operate them (eg a two-way radio, roof-mounted flashing lights, and electronic testing or monitoring equipment).

Business accessories are items permanently affixed to the vehicle. Permanency is not negated if the accessory is removed from the vehicle temporarily for repair or maintenance, or on the removal of the accessory at the time of sale or disposal of the vehicle or the accessory itself [see Public ruling BR Pub 09/08, TIB 22:1 (February 2010) at 3-12 which applies from 1 November 2008].

540.105 Three-month test period [ss RD 31, RD 32]

Rather than keep a continuous record of the days a motor vehicle is available for private use, an employer may instead keep a record of use for a three-month test period. The result of the test period is then used as the basis for calculating the employer’s FBT liability for a period of three years [s RD 31]. When the test period must be run, and when the three-year application period starts, is illustrated below.

<table>
<thead>
<tr>
<th>FBT period</th>
<th>Test period</th>
<th>Start of three-year application period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quarterly</td>
<td>One full FBT quarter</td>
<td>First day of the test period</td>
</tr>
<tr>
<td>Annual</td>
<td>One full quarter in the year</td>
<td>1 April of the tax year in which the test period was run</td>
</tr>
<tr>
<td>Income year</td>
<td>Any three consecutive months in the year</td>
<td>First day of the income year</td>
</tr>
</tbody>
</table>

The test period chosen must be representative of the normal use of the vehicle over the application period. The employer must keep a record of the use of the vehicle during the test period, including accurate details of the days the vehicle was available for private use by the employee. Days on which the vehicle is a work-related vehicle are treated as days the vehicle is not available for private use.

If the actual number of days of private use (excluding days on which the vehicle is a work-related vehicle) is 20 per cent or more higher than the test period number, the application period will end on the last day of the FBT period. The employer will then need to either start another test period or revert to recording all private use.

If Inland Revenue considers that the test period number is not fairly representative of the actual private use of the vehicle, they may notify the employer that the application period will end on a specific date and that the test period number may no longer be used.

If the vehicle for which the test period record was kept is replaced by another vehicle, the test period number can continue to be used for the new vehicle until the end of the original application period, provided the test period number remains representative of the average private use of the vehicle.

540.110 Motor vehicle available to more than one employee [s CX 8]

If one motor vehicle is made available for private use by more than one employee on the same day, only one fringe benefit is deemed to be provided on that day. The value of the benefit is calculated as if only one
employee had used the vehicle privately on that day. If more than one employee pays the employer for the private use of the vehicle on the same day, the sum of all the amounts paid is deducted from the value of the benefit in arriving at the taxable value [see 540.260].

540.115 Motor vehicle lease arrangements [s CX 7]
The tax advantages of the following types of lease arrangements were eliminated by s CX 7 [see 540.60] and amendments to sch 5 [see 540.90]:
(a) Nine-to-five leases;
(b) Flip-flop leases;
(c) Yearly renewable leases; and
(d) Multi-leases.
A detailed explanation of these lease arrangements and their effect before 1 April 2006 can be found in Staples Tax Guide (2006) 540.115.

540.125 Subsidised transport [ss CX 9, RD 33, YA 1]
The provision of subsidised transport by an employer, or group company, to an employee, or by a third party to an employee on behalf of the employer, is a fringe benefit [ss CX 2(2), CX 9].

“Subsidised transport” means the provision of transport (excluding transport in a motor vehicle) to an employee by the employer or group company if:
(a) The employer or group company carries on a business that consists of or includes transporting the public for hire or reward;
(b) The employer or group company provides the transport to the employee in the course of transporting the public; and
(c) The amount the employee pays for the transport is less than the highest amount charged by the employer or group company to the public for transport that is equivalent in terms of class, extent and occasion to that provided to the employee [s YA 1].

“Group company” means a company which is in the same group of companies as the employer. Subsidised transport provided to employees by a company in the same group of companies as the employing company is valued in the same way as if the employer had provided the benefit directly.

Subsidised transport also includes the provision by an employer or group company to an employee of an entitlement to transport, provided the above conditions are met. The exclusion for transport in a motor vehicle will, in most cases, not extend to motor coaches and buses because the definition of “motor vehicle”, for FBT purposes, excludes any vehicle with a gross laden weight exceeding 3,500 kg [s YA 1].

When a person with whom the employer has entered into an arrangement (ie a third party) provides a benefit to an employee, the benefit is deemed to be provided by the employer [s CX 2(2)]. Thus, transport provided to an employee by a third party is also a fringe benefit, provided the employer is itself in the public passenger transportation business.

The value of a benefit that consists of subsidised transport is 25 per cent of the highest fare the employer or group company charges the public for equivalent transport in terms of class, extent, and occasion. If a third person provides subsidised transport to an employee under an arrangement with the employer, the value of the benefit is the greatest of:
(a) Twenty-five per cent of the highest fare the employer charges the public for equivalent transport (in terms of class, extent and occasion);
(b) Twenty-five per cent of the highest fare the third person charges the public for equivalent transport (in terms of class, extent and occasion), if the third person is a company in the same group of companies as the employer; and
(c) The amount that the employer pays the third person for the benefit [s RD 33].
The word "amount", in this context, means the GST-inclusive amount if the employer is a registered person and can claim input tax for the subsidised transport. The taxable value of the benefit is the value of the subsidised transport, as determined above, reduced by any amount paid by the employee for that benefit.

“Class” refers to the classes of transportation available, such as first, business or economy class. Standby (subload) travel is not considered by Inland Revenue to be a separate class of transportation. “Extent” refers to transportation with the same departure and destination points. “Occasion” refers to the time of carriage.

Example 1:
An airline employee takes an overseas holiday on his employer’s airline. He travels economy class. The highest price charged to the public for a ticket on that flight in economy class, with the same departure and destination points, is $650. The employee pays $200.
(a) Highest fare charged to the public for the same flight = $650.00
(b) Twenty-five per cent of that fare = $162.50
As the employee pays more than the value of the benefit ($200 compared to $162.50), the taxable value of the benefit is nil and no FBT is payable by the employer.

Example 2:
An airline employee takes a holiday overseas on an airline that has an agreement with her employer. The highest price charged to the public for travel of the same class, extent, and occasion is $650. Under the agreement the employee’s airline pays $325 to the airline that carries the employee.
(a) Highest fare charged to the public for the same flight = $650.00
(b) Twenty-five per cent of that fare = $162.50
(c) Price payable by the employer = $325.00
The price paid by the employer is greater than twenty-five per cent of the highest fare charged for the flight. As the employee does not make any contribution, the taxable value of the benefit is $325. If the employee pays the employer $200, that amount would be deducted from $325 and the taxable value of the benefit would be $125.

Where expenditure incurred by an employer results in a fringe benefit consisting of subsidised transport, the taxable value of the benefit is nil, provided:
(a) The expenditure was incurred in relation to the employee’s employment duties, and not in relation to the taking of leave or vacation by the employee; and
(b) The expenditure would not have been less if the fringe benefit had not resulted from it.

Example 3:
An airline employee is flown from Wellington to Auckland to attend a work conference and after the conference takes a week’s leave in Auckland. As the expenditure was not incurred directly in respect of or in relation to the leave taken by the employee, and the expenditure would not have been less had the fringe benefit not resulted from it (assuming there were no seasonal price variations resulting in an increased cost in flying the employee back to Wellington a week later), the value of the fringe benefit would be nil.

540.130 Low-interest loans [ss CX 2, CX 10, RD 34, RD 35]
Any loan owing by an employee to an employer gives rise to a fringe benefit if the loan was provided because of the employment relationship [ss CX 2(1), CX 10(1)]. However, a liability for FBT only arises if, and to the extent that, the rate of interest charged on the loan is less than the prescribed interest rate [s RD 34] or, if an election is made under s RD 35 [see 540.132], the market interest rate. The prescribed interest rate is intended to be an approximation of the market interest rate.

A “loan” (defined the same as “money lent”) is:
(a) An amount of money that a person lends in some way, including by depositing it in an account, whether or not the lending is secured or evidenced in writing;
(b) An amount of credit that a person gives, including by not enforcing a debt, whether or not the giving is secured or evidenced in writing;
(c) An amount of money that a person lends, or credit that a person gives, under an obligation or arrangement, whether or not secured or evidenced in writing;
(d) An amount of money that goes (ie is paid) from person A to person B in consideration for person B’s promise to pay person A an amount of money and that is less than the amount that person B promises to pay person A. Person B’s promise is not required to be secured or evidenced in writing. Person B includes any other person with whom person B is associated [s YA 1].

The value of the benefit provided by an employment-related loan for an FBT period using the prescribed interest rate is [s RD 34]:

\[
\text{prescribed interest} - \text{actual interest}
\]

The “prescribed interest” is the amount of interest on the loan for the FBT period calculated at the prescribed interest rate on the daily balance of the loan. The prescribed interest rates are listed in 540.135.

If the loan was made before 1 April 1985 and the rate of interest on the loan is non-reviewable, the prescribed interest is calculated using the non-concessionary rate of interest for the year in which the loan was entered into. The non-concessionary rates of interest are available on the Inland Revenue website.

In Waitomo District Council v Commissioner of Inland Revenue (1987) 9 NZTC 6,185 (HC), the taxpayer granted a loan to one of its employees before the introduction of FBT. The loan was secured by a mortgage over the employee’s property. The mortgage contained no review of interest rate provision. Inland Revenue assessed the loan as subject to FBT. The High Court held that if a loan agreement contains no express provision providing for an interest review, the interest rate on the loan is presumed to be non-reviewable. An express negative provision is unnecessary.

The “actual interest” is:
(a) The amount of interest that actually accrued on the loan for the FBT period; or
(b) If the loan is a financial arrangement and it is appropriate for the nature of the loan, the income that would have accrued to the employer’s benefit in the period as calculated under the yield-to-maturity method.

### Example:

Jane has a $10,000 employment-related loan from her employer. During the quarter ended 30 September 2011, her employer charged her interest on the loan at the rate of four per cent per annum. The prescribed interest rate during the quarter was 5.90 per cent. She made no principal repayments during the quarter. There are 92 days in the quarter. The value of the fringe benefit is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prescribed interest</td>
<td>$10,000 × 5.90% × 92 / 365</td>
</tr>
<tr>
<td>Less Actual interest</td>
<td>$10,000 × 4% × 92 / 365</td>
</tr>
<tr>
<td>Value of fringe benefit</td>
<td></td>
</tr>
</tbody>
</table>

(1) Excluded loans [s CX 10(2)]

The following loans are not subject to FBT:
(a) An employee share loan [see 540.205];
(b) A loan made under a share purchase scheme [see 340.10];
(c) Before 1 April 2011 a loan made by a superannuation fund, to the extent to which the value of the loan constitutes income of the fund under s CS 18 [see 1390.15]; and
(d) An advance of salary or wages, if the total amount owing by the employee from all such advances does not exceed $2,000 during the FBT period and the employer is not required under the contract of employment to make the advance.

### 540.132 Option to value loan benefit at market interest rate [s RD 35]

An employer who is in the business of lending money to the public (eg a bank) may choose to calculate the value of a benefit for an employment-related loan using the market interest rate. The market interest rate is
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540.135

defined as the interest rate that would apply to a borrower belonging to a group that has similar characteristics to the group to which the employee belongs, determined on an arm’s length basis.

The comparable group must meet the following criteria:

(a) The group has a comparable credit risk to the employee group;
(b) Membership of the group does not arise because of a link between the member and the employer;
(c) The group is large enough to ensure a transaction on an arm’s-length basis.

This requirement could cover rates offered to the general public, and rates offered to a defined group (not associated with the employer) that is comparable in credit risk to the employee group.

The value of the benefit provided by an employment-related loan for an FBT period using the market interest rate is the amount by which interest calculated on the loan at the market interest rate exceeds:

(a) The actual amount of interest that accrued on the loan during the period; or
(b) If the loan is a financial arrangement and it is appropriate having regard to the nature of the loan the amount of interest that accrued on the loan using the yield-to-maturity method.

Interest calculations must be made on the daily balance of the loan. If an employer elects to use the market interest rate method, the employer must use this method for the current income year and the following income year (i.e., for a minimum of two income years). An employer can change method only by giving notice to the CIR at least one year before the start of the income year in which the change will occur.

An employer makes an election to apply the market interest rate in respect of each employment-related loan. There is no requirement to apply this method to all employees. Similarly, different market interest rates could apply to different employees if they are assessed as falling within different risk categories.

540.135 Prescribed interest rates for low-interest loans [s RA 21(3)]

Prescribed interest rates for low-interest loans are set by regulation under s RA 21(3) and published by Inland Revenue in the TIBs and on its website at www.ird.govt.nz. The following is a list of prescribed interest rates. For earlier rates see Brookers Tax Rates Guide 5-4500 or earlier editions of Staples Tax Guide.

<table>
<thead>
<tr>
<th>From</th>
<th>To</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 October 2002</td>
<td>31 March 2003</td>
<td>7.83</td>
</tr>
<tr>
<td>1 April 2003</td>
<td>30 June 2003</td>
<td>7.74</td>
</tr>
<tr>
<td>1 July 2003</td>
<td>30 September 2003</td>
<td>7.33</td>
</tr>
<tr>
<td>1 October 2003</td>
<td>31 March 2004</td>
<td>7.08</td>
</tr>
<tr>
<td>1 April 2004</td>
<td>30 June 2004</td>
<td>7.30</td>
</tr>
<tr>
<td>1 July 2004</td>
<td>30 September 2004</td>
<td>7.50</td>
</tr>
<tr>
<td>1 October 2004</td>
<td>31 December 2004</td>
<td>8.02</td>
</tr>
<tr>
<td>1 January 2005</td>
<td>31 March 2005</td>
<td>8.52</td>
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<td>1 April 2005</td>
<td>30 June 2005</td>
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<td>1 July 2005</td>
<td>31 March 2006</td>
<td>9.01</td>
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<tr>
<td>1 April 2006</td>
<td>30 June 2007</td>
<td>9.55</td>
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<tr>
<td>1 July 2007</td>
<td>30 September 2007</td>
<td>9.79</td>
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<tr>
<td>1 October 2007</td>
<td>31 March 2008</td>
<td>10.37</td>
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<td>1 April 2008</td>
<td>30 September 2008</td>
<td>10.57</td>
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<td>1 October 2008</td>
<td>31 December 2008</td>
<td>10.90</td>
</tr>
<tr>
<td>1 January 2009</td>
<td>30 June 2009</td>
<td>8.05</td>
</tr>
</tbody>
</table>

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540.140 Deemed reduction of loan balance [s RD 36]

Any income paid to an employee during a tax year which is applied in reduction of an employment-related loan owing by the employee is deemed to be applied in repayment of the loan on the first day of the income year or on the date the loan was advanced, whichever is the later [s RD 36]. This only applies when an employee derives income that is:

(a) Salary or wages, an extra pay, a dividend or interest;

(b) Payable to the employee without any amount of tax withheld under the PAYE rules, the RWT rules, or the NRWT rules; and

(c) Income of the employee in the tax year in which it is applied to repay the loan, or in an earlier income year.

This provision typically applies to shareholder-employees with a current account in debit who receive a lump-sum salary payment at or following the end of the year, which is credited to the current account, eliminating all or part of the debit balance. The amount is deemed to have been credited at the start of the tax year, or on the date the current account first went into debit, whichever is the later.

If a company has a non-standard accounting year, the income applied in repayment of the loan is deemed to have been applied on the first day of that accounting year or the date the loan was advanced, whichever is the later.

An employee may elect that an amount of income derived in a tax year and applied in repayment of an employment-related loan be treated as derived in the income year preceding the year in which it would otherwise be treated as derived. The election must be given in writing to Inland Revenue by the due date for filing the tax return for the year in which the loan is owed.

540.145 Loans provided by life insurers [s CX 11]

Loans made by life insurers to their policyholders (or associated persons of policyholders) are subject to FBT as employment-related loans if the loan was granted, or the interest rate set, because of the person’s status as a policyholder. This applies whether the loan is provided by the life insurer directly, by an associated person, or by a person with whom the life insurer has entered into an arrangement. The meaning of “associated person” is explained in 70.20.

540.150 Promissory notes

Loans made to employees by way of promissory notes and other similar financial arrangements are liable to FBT as employment-related loans [see 540.130].

Normally, FBT is payable on the difference between the interest actually accrued under a loan and the prescribed interest. However, in the case of financial arrangements with no interest payments (ie promissory notes), the interest accrued is substituted for the income (if any), that would have accrued to the employer using the yield-to-maturity method.

Example:

An employee sells a promissory note, with a face value of $1,000 and a term of five years, to his employer for $800. Assume the prescribed rate of interest is 8.5 per cent. FBT is payable on the difference between $1,000 × 8.5 per cent ($85.00), if calculated on a yearly basis, and the income accruing to the employer using the yield-to-maturity method. The figures are as follows:

<table>
<thead>
<tr>
<th>Prescribed Interest</th>
<th>YTM income</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1</td>
<td>$85</td>
<td>$36.51</td>
</tr>
</tbody>
</table>
Fringe Benefit Tax

<table>
<thead>
<tr>
<th></th>
<th>Prescribed interest</th>
<th>YTM income</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X2</td>
<td>$85</td>
<td>$38.18</td>
<td>$46.82</td>
</tr>
<tr>
<td>20X3</td>
<td>$85</td>
<td>$39.92</td>
<td>$45.08</td>
</tr>
<tr>
<td>20X4</td>
<td>$85</td>
<td>$41.74</td>
<td>$43.26</td>
</tr>
<tr>
<td>20X5</td>
<td>$85</td>
<td>$43.65</td>
<td>$41.35</td>
</tr>
</tbody>
</table>

In some cases promissory notes are sold at face value, so there is no income accruing to the employer and no yield-to-maturity calculation is required. FBT will be payable on the total amount of the prescribed interest in such cases. Source: Inland Revenue Technical Rulings Manual, 67.14.2.

### 540.152 Credit cards provided by charities [ss CX 25(2), (3), RD 39]

Benefits provided by way of short-term charge facilities (eg credit cards) by a charitable organisation to an employee are subject to FBT if the value of the benefit for the tax year exceeds five per cent of the employee’s salary or wages for the tax year [s CX 25(2)].

A “short-term charge facility” is defined as an arrangement that enables an employee to buy or hire goods or services (that have no connection with the charity or its operations) or charge them to an account, and places some or all of the liability for paying for them on the charity. Short-term charge facilities do not include employment-related loans covered under s CX 10 [s CX 25(3)].

The value of the benefit is the sum of:

(a) The amount that the charity pays towards the purchase or hire of the goods and services obtained by the employee under the short-term charge facility;
(b) Any interest incurred in relation to such purchases (eg credit card interest); and
(c) The associated account or service fees, if the facility is a credit card or a charge card provided solely for an employee’s private use [s RD 39(1)].

If the charitable organisation pays FBT on a quarterly basis, no FBT is payable in a quarter unless the accumulated benefit value (ie the total taxable value of benefits provided to the employee under a short-term charge facility since the beginning of the tax year) exceeds the threshold benefit value (ie five per cent of the employee’s salary or wages for the tax year). In the first quarter in the tax year in which the accumulated benefit value exceeds the threshold benefit value, FBT is payable on the accumulated benefit value. In any subsequent quarter of that tax year, FBT is payable on the taxable value of the benefits provided in that quarter [s RD 39(2)-(4)].

#### Example 1:
Alpha Charity provides one of its employees with a remuneration package that includes a salary of $30,000 a year and a credit card to which the employee is able to charge personal expenditure. The charity pays all charges to the credit card account, up to a maximum of $5,000 for the year. In the quarter ended 30 June 20X1, Alpha Charity pays for goods costing $1,735 charged to the credit card. Alpha Charity is required to pay FBT on $1,735 in the first quarter because the taxable value of the benefits provided exceeds five per cent of the employee’s annual salary (five per cent of $30,000 is $1,500). Any benefits provided in the following three quarters will also be taxable.

#### Example 2:
Beta Charity provides one of its employees with a remuneration package that includes a salary of $50,000 a year and a credit card to which the employee is able to charge personal expenditure. The charity pays for all charges to the credit card account, up to a maximum of $5,000 for the year. Beta Charity pays for private goods and services charged to the credit card during each quarter as follows:

<table>
<thead>
<tr>
<th>Quarter ended</th>
<th>Card payments</th>
<th>Year-to-date payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 June 20X1</td>
<td>$1,036</td>
<td>$1,036</td>
</tr>
<tr>
<td>30 September 20X1</td>
<td>$1,179</td>
<td>$2,215</td>
</tr>
<tr>
<td>31 December 20X1</td>
<td>$1,485</td>
<td>$3,700</td>
</tr>
<tr>
<td>31 March 20X2</td>
<td>$1,300</td>
<td>$5,000</td>
</tr>
</tbody>
</table>
In the first two quarters, Beta Charity has no FBT liability because year-to-date payments have not exceeded five per cent of the employee’s salary for the tax year (five per cent of $50,000 is $2,500). In the third quarter, year-to-date payments exceed five per cent of the employee’s annual salary and so Beta Charity is liable to pay FBT on the taxable value of $3,700. In the fourth quarter, Beta Charity is required to pay FBT on the credit card payments it makes during that quarter ($1,300).

Note: The legislation does not address the issue of how the employing charity is to determine the amount of the employee’s salary or wages for the tax year, in the first three quarters. If the employee is on a salary that is fixed for the year, the five per cent threshold could be determined on this basis. However, if an employee’s salary were to increase during the tax year (eg because of a promotion), as a result of which benefits drop below five per cent of annual salary, how would FBT paid in earlier quarters be recovered? Similarly, if the employee is paid wages on an hourly basis, the amount payable for the full tax year may be difficult to predict. Hopefully future legislation will deal with these issues.

540.155 Sickness, accident or death benefit funds [ss CX 14, RD 38(1), YA 1]
A contribution by an employer to a sickness, accident or death benefit fund for the benefit of an employee is a fringe benefit if made because of the employment connection [s CX 14].

A “sickness, accident or death benefit fund” is defined in s YA 1 as a sickness, accident or death benefit fund, approved by the CIR, that is established for the benefit of:

(a) Employees;
(b) Members of an incorporated society; or
(c) Surviving spouses [see 960.10] and dependents of deceased employees or members of an incorporated society.

The value of the benefit is the amount of the contribution made by the employer [s RD 38].

540.160 Contributions to funeral trusts [ss CW 45, CX 15, RD 38(2)]
Any contribution, by an employer to a funeral fund for the benefit of its employees and their families is a fringe benefit if the contribution is made by virtue of the employment relationship. A fringe benefit will arise only if the fund meets the following criteria:

(a) The sole purpose of the fund is to pay the expenses of the funerals of
   (i) Employees and their spouses [see 960.10] and dependants;
   (ii) The surviving spouses and dependants of deceased employees;
(b) The employer has at least 10 employees;
(c) All persons eligible for benefits from the fund are equally eligible;
(d) The only contributors to the fund are the employer and its employees; and
(e) The fund is approved by the CIR [ss CX 15, CW 45].

The value of the benefit is the amount of the contribution made by the employer during the relevant quarter or year [s RD 38(2)]. Any interest or dividends received by the trustee of the fund is exempt from income tax under s CW 45 [see 370.15].

540.165 Specified insurance premiums [ss CX 16, CZ 15, RD 38(3), (4)]
A specified insurance premium paid, or a contribution to an insurance fund of a friendly society made, by an employer for the benefit of an employee is a fringe benefit [s CX 16(1)].

A “specified insurance premium” [s CX 16(3)] is a premium paid for the benefit of an employee, their spouse [see 960.10] or their child on a policy of one of the following types:

(a) An insurance policy on the life of the employee or their spouse or child, which meets the criteria set out in s CX 16(4);
(b) A life insurance policy which provides pension benefits [s CX 16(5)]; or
(c) An insurance policy that provides benefits for an accident, disease, or sickness of the employee, their spouse or their child [s CX 16(6)].
A “friendly society” is a society, credit union or association of credit unions registered under the Friendly Societies and Credit Unions Act 1982 [s YA 1].

The value of the benefit is the amount of the premium paid or contribution made by the employer [s RD 38(3), (4)]. If the employer is registered for GST and is able to claim an input tax deduction for the premium, the amount of the benefit is the GST-inclusive amount. A premium or contribution is not a fringe benefit if it relates to an accident insurance contract, or cover and entitlements for work-related personal injury, in force before 1 July 2000 [ss CX 16(2), CZ 15].

540.170   Discounted premiums on life agents’ insurance policies

When a life agent or a person associated with the life agent [see 70.20, 70.45], receive discounted premiums on a life insurance policy from the life agent’s employer, the policy will be a fringe benefit under s CX 2 if it is provided in connection with the life agent’s employment. The life insurer will be liable for FBT on the taxable value of the benefit. The value of the benefit is the amount by which the amount normally paid by the general public for the same type of policy exceeds the amount paid by the life agent or associated person. [Public ruling BR Pub 10/08, TIB vol 22:5 (June 2010) at 8-17 applies from the first day of the 2008-2009 income year].

540.175   Superannuation scheme contributions [ss CX 13, CX 32, RD 37, RD 65]

A contribution by an employer to a superannuation scheme for the benefit of an employee is a fringe benefit if the contribution is not an “employer’s superannuation cash contribution” [s CX 13]. An “employer’s superannuation cash contribution” is a contribution in money made to a superannuation fund by an employer for the benefit of one or more employees [s RD 65]. This means that only non-monetary superannuation scheme contributions are subject to FBT. An example of a non-monetary contribution is the provision of services or office space by an employer to an employee superannuation scheme.

The provision of services to a superannuation fund is not subject to FBT if the expenditure would have been deductible if it were incurred by the superannuation fund itself [s CX 32].

A “superannuation scheme” [s YA 1] is:

(a) A trust or unit trust established by its trust deed mainly to provide retirement benefits to natural persons or to pay benefits to superannuation funds;
(b) A non-resident company (that is not a unit trust) established mainly to provide retirement benefits to members or their relatives who are natural persons; or
(c) An arrangement constituted under an Act of Parliament of New Zealand, other than the Social Security Act 1964, mainly to provide retirement benefits to natural persons; or
(d) An arrangement constituted under the legislation of a country, state or local authority outside New Zealand mainly to provide retirement benefits to natural persons.

The value of the benefit is the amount of the contribution made by the employee. If the employer is registered for GST and is able to claim an input tax deduction for the contribution, the amount is the GST-inclusive amount [s RD 37].

Monetary contributions to employee superannuation schemes (referred to as “employer’s superannuation benefits”) are not subject to FBT, but give rise to a liability for employer’s superannuation contribution tax [see 1080.105, 1390.45].

540.180   Unclassified benefits [ss CX 2(1)(b)(ii), CX 37]

A benefit other than those described in the preceding paragraphs (as described in ss CX 6 to CX 16), provided by an employer to an employee in connection with their employment, is also a fringe benefit if it is not an excluded benefit. These other benefits are referred to as “unclassified benefits”.

Unclassified benefits consist primarily of free, subsidised or discounted goods and services provided by employers to employees.
540.185  **Free or discounted goods** [s RD 40]

When an employer (or another person under an arrangement with the employer) makes free, discounted, or subsidised goods available to its employees, a fringe benefit may arise. The value of the fringe benefit is determined as illustrated below.

<table>
<thead>
<tr>
<th>Origin of goods</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods manufactured, produced or processed by the employer (or other person providing them).</td>
<td>The market value of the goods. “Market value” means the lowest GST-inclusive price, at the time the goods were provided to the employee, for which identical goods were sold to an arm’s length buyer (whether wholesaler, retailer, or the public) in the open market in New Zealand in sales on ordinary trade terms.</td>
</tr>
<tr>
<td>Goods purchased by the employer (or other person providing them) from the supplier in an arm’s length deal.</td>
<td>The cost of the goods. “Cost” means the GST-inclusive cost, if the purchaser can claim an input tax credit.</td>
</tr>
<tr>
<td>The employer (or other person) providing the goods is a company included in a group of companies.</td>
<td>Either the market value or the cost of the goods (as explained above), at the option of the company. The amount is determined as if the group of companies were a single company.</td>
</tr>
</tbody>
</table>

The value determined under the rules shown above may not exceed the GST-inclusive open market retail price of the goods. The open market retail price is the price that would apply to a sale that is:

(a) At retail in the open market in New Zealand;
(b) Freely offered;
(c) Made on ordinary trade terms; and
(d) To a member of the public with whom the employer is at arm’s length.

**Example 1:**
Craig, a machinist employed by a bicycle manufacturing company, was given a mountain bike by his employer as a reward for exceeding his yearly production target. The lowest price at which the company sells this model wholesale is $775, including GST. The value of the fringe benefit is $775.

**Example 2:**
A hardware store sells a lawnmower to the public for $399, including GST. The store purchases this model from the manufacturer for $285, including GST. Fiona, an employee, was allowed to purchase one of these lawn mowers at the normal staff discount price of $325, including GST. In this case, no fringe benefit has been provided because Fiona paid more than cost. A fringe benefit would arise only if the lawn mower were sold to her at less than $285 (including GST).

540.190  **Free or discounted services** [s RD 41]

When an employer (or another person under an arrangement with the employer) makes free, discounted or subsidised services available to its employees, a fringe benefit may arise. This does not apply to the making available of a motor vehicle for private use, providing an employment-related loan, or providing subsidised transport — these services are treated as fringe benefits under separate provisions.

The value of the fringe benefit is determined as illustrated below.

<table>
<thead>
<tr>
<th>Type of service</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Services provided by employer as part of the employer’s normal business.</td>
<td>The GST-inclusive price charged by the employer, at the time the services were provided, for the same or similar services to the public in the open market in New Zealand.</td>
</tr>
</tbody>
</table>
Fringe Benefit Tax

540.190(1)

<table>
<thead>
<tr>
<th>Type of service</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Zealand on ordinary trade or professional terms between independent buyers and sellers.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>The GST-inclusive amount that the employer is liable to pay for the services.</td>
</tr>
<tr>
<td>The GST-inclusive price or fee that the employer or supplier of the services would have charged the public for the same or similar services in the open market in New Zealand on ordinary trade or professional terms.</td>
</tr>
</tbody>
</table>

Example:
A dentist’s receptionist, as part of her conditions of employment, receives dental treatment at 50 per cent of the normal fee charged by her employer. During a quarter, she received three hours of treatment. The normal charge to the public is $130 (including GST) per hour. The receptionist is charged $65 per hour. The value of the benefit is $195 \[($130 – $65) \times 3\].

A person who provides services to a group of employees is treated as providing the same or similar services to the public in the open market on ordinary trade or professional terms if the person provides the same or similar services to a group of persons that:

- Negotiates the transaction on an arm’s-length basis; and
- Is comparable in number to the group of employees.

(1) Employee’s home telephone costs
When an employer pays the cost of an employee’s home telephone, the tax treatment depends on who has actually contracted for the supply of the service.

If the employee has contracted with the telephone company for the supply of the telephone service, but the employer pays for it (either by reimbursement or by direct payment), the employee is liable for income tax on any amount that the employer pays that is not an exempt reimbursing allowance under s CW 17. The employer must deduct PAYE from such payments. No FBT liability arises in this situation.

If the employer contracts directly with the telephone service provider for the provision of telephone services to an employee, payment of the rental and toll accounts is a fringe benefit. Any amount that cannot be justified as an exempt allowance will be subject to FBT. In this situation, the employee will not be liable for income tax on any amount the employer pays.

Inland Revenue’s policy on the payment of employee home telephone costs is set out in TIB vol 4:8 (April 1993) at 4-5.

(2) Expatriates’ home leave travel
Free or subsidised travel provided by employers to expatriate employees, to enable them to travel overseas on recreational leave, is liable for FBT.

Organisations may arrange for their employees to work overseas, whether by being employed by overseas employers (secondment), or by remaining with the same employer and being posted overseas for a period. Sometimes the employer provides free or subsidised return overseas travel so that employees (sometimes with their families), can return to their home country for holidays.

Employers who are New Zealand taxpayers are liable for FBT on travel benefits they provide to their expatriate employees (and/or associated persons of those employees) to enable them to take recreational leave overseas. Travel benefits are fringe benefits under either s CX 9 [see 540.125] or s CX 37 [see 540.275].

(3) Brokerage provided by sharebrokers to employees
It is the CIR’s view that, for FBT purposes, the value of brokerage services provided by sharebrokers to their employees is the amount that would be charged by the employer to a member of the general public. The value is thus to be determined on a transaction-by-transaction basis according to the sharebroker’s normal scale of
charges. Brokerage rates are normally calculated on a graduating scale based on the size of the trade, subject to a minimum charge. A “trader rate” may also apply to customers (and employees) who have traded in excess of a specified amount of brokerage. A lower rate may also be charged for online brokerage services [see TIB vol 18:2 (March 2006) at 25-26].

540.193 US Federal Insurance Contributions

Under the United States Federal Insurance Contributions Act (FICA), United States employers may be required to make deductions from the wages of USA citizens working outside the United States, to fund social security benefits. Such employers may also be required to make contributions themselves under the same Act.

Employer contributions paid, and employee contributions required to be deducted from wages and paid under FICA, do not give rise to a fringe benefit and are therefore not subject to fringe benefit tax (FBT) [see Public ruling BR Pub 09/02, TIB vol 21:4 (June 2009) at 2-9].

540.195 Default method of determining value [s RD 27(2), (3)]

If the value of a particular fringe benefit is unable to be determined under ss RD 28, RD 29, RD 33, RD 34, RD 35, RD 36, RD 37, RD 38, RD 39, RD 40 and RD 41, the value of the benefit is the market value or the value determined by the CIR. For these purposes “market value” means the price, at the time the goods or services were provided to the employee, for which the goods or services would normally sell in the open market in New Zealand to a member of the public at arm’s length if freely offered and made on ordinary trade terms.

540.200 Excluded benefits — general scope [s CX 2(1)(c)]

The following benefits are excluded benefits and are therefore not subject to FBT:

<table>
<thead>
<tr>
<th>Excluded benefit</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>A benefit provided by an employer to an employee in connection with their employment, to the extent that it is assessable income (e.g., salary and wages).</td>
<td>s CX 4</td>
</tr>
<tr>
<td>A benefit provided by an employer to an employee in connection with their employment, to the extent that it is exempt income. The exclusion does not include: (a) an exempt reimbursing allowance [s CW 17] provided by an employer to enable an employee to provide a benefit to another person; or (b) A payment by an employer of a life insurance premium that is excluded from being expenditure on account of an employee under s CE 5(3)(f) to (i).</td>
<td>s CX 5(1), (2)</td>
</tr>
<tr>
<td>A benefit provided by an employer to an employee in connection with their employment, to the extent that it would have been exempt income if paid in cash. This does not apply to interest, dividends, or an exempt reimbursing allowance provided by an employer to enable an employee to provide a benefit to another person.</td>
<td>s CX 5(3), (4)</td>
</tr>
<tr>
<td>The private use of a motor vehicle by an employee when the vehicle is a work-related vehicle.</td>
<td>s CX 6(2), 540.85</td>
</tr>
<tr>
<td>The private use of a motor vehicle by an employee on any day the vehicle is used for an emergency call.</td>
<td>s CX 6(3), 540.75</td>
</tr>
</tbody>
</table>
Fringe Benefit Tax 540.200

**Excluded benefit**

The private use of a motor vehicle by an employee when the employee is regularly absent from home on business trips.

Employee share loans.

Loans provided under an employee share purchase scheme.

A loan provided by a superannuation fund to the extent the loan constitutes income to the fund.

An advance of salary or wages if the total advances outstanding by the employee do not exceed $2,000 at any time during the FBT period, and the employment contract does not require the employer to make the advance.

An employer’s superannuation contribution. Such contributions are subject to employer’s superannuation contribution tax or PAYE.

A specified insurance premium or any contribution to the insurance fund of a friendly society that relates to an accident insurance contract, or cover and entitlements for work-related personal injury, in force before 1 July 2000.

A benefit provided by an employer to an employee, in connection with their employment, to the extent that it removes a need, that would otherwise exist, for the employer to pay the employee an exempt allowance under s CW 13, provided it does not enable the employee to provide a benefit to another person.

A benefit provided by an employer to an employee, in connection with their employment, to the extent that it removes a need, that would otherwise exist, for the employer to pay the employee an allowance for additional transport costs.

A benefit provided by an employer to an employee, in connection with their employment, to the extent that it removes a need, that would otherwise exist, for the employer to pay the employee an exempt relocation payment under s CW 17B.

A benefit provided by an employer to a relative of an employee, instead of to the employee under s CX 19(1)(b), because the employee has a temporary change in their place of work while in the same employment. Certain restrictions apply.

A benefit by way of subsidised transport or expenditure incurred by an employer on transport or accommodation, if the expenditure relates to work-

**Reference**

s CX 6(4), 540.80

s CX 10(2)(a), 540.205

s CX 10(2)(b)

s CX 10(2)(c)

s CX 10(2)(d)

s CX 13(2), 540.175

ss CX 16(2), CZ 15

s CX 19(1)(a), 540.227

s CX 19(1)(b), 540.227. Additional transport costs are defined in s CW 18(3).

s CX 19(1)(c), 540.227, 330.40

s CX 19(2), 540.227

s CX 20, 540.125, 540.275
Excluded benefit

- Related travel, does not relate to leave or a vacation and is not increased as a result of the benefit.
- The private use, and the availability for private use, of business tools with a GST-inclusive cost not exceeding $5,000.
- A transfer of value to a non-executive director that is a dividend under s CD 20(2), if made solely because of their capacity as a non-executive director.
- A benefit provided by an employer that is used or consumed by an employee on the employer’s premises. The exemption does not apply to free, discounted, or subsidised travel, accommodation or clothing, nor to benefits received on premises occupied by an employee for residential purposes. This exemption also applies to benefits provided on the premises of other companies in the same group of companies as the employer.
- Benefits provided by an employer to an employee that relate to the employee’s health or safety.
- A benefit provided by a charitable organisation to an employee, except when the employee is engaged in a non-charitable business activity.
- A benefit received by an employee who derives PAYE income payments, none of which are liable for income tax.
- An employer’s assistance with the preparation of an employee’s tax return or income statement [see 1270.75].
- The value of accommodation that an employer provides to an employee in connection with the employment or services. “Accommodation” is defined as board or lodging, or the use of a house or living premises, or the use of part of a house or living premises. [This type of benefit is assessable income for the employee under s CE 1(c)].
- A benefit consisting of entertainment, provided by an employer to an employee, to which the limitation rule [s DD 2] applies. Exceptions apply.
- Distinctive work clothing provided, by sale or otherwise, to an employee by an employer.
- Income protection insurance premiums paid by an employer, where the policy is for the benefit of an employee and any payment of insurance would be assessable income of the employee.
- A benefit by way of the provision of services to a superannuation fund to the extent that the expenditure

Reference

- s CX 21, 540.247
- s CX 22
- s CX 23, 540.230, 540.235
- s CX 24, 540.242
- s CX 25(1), 540.215
- s CX 26, 540.220, 540.225
- s CX 27, 540.210
- s CX 28, 330.45
- s CX 29, 540.240
- s CX 30, 540.245
- s CX 31
- s CX 32
Excluded benefit

incurred would have been an allowable deduction of the superannuation fund, if incurred by the fund.

Bulk discounts secured at arm’s-length through unrelated third parties by employers for their employees.

Unclassified benefits totalling less than $300 per employee per quarter, if the total such benefits provided to all employees is less than $22,500 for the year.

A benefit provided to an employee, within eight weeks of 4 September 2010 or 22 February 2011, to give them relief from the adverse effects of the Canterbury earthquake. The exclusion is subject to a number of restrictions.

540.205 Employee share loans [ss CX 10(2)(a), CX 35]

Employee share loans are not subject to FBT. An “employee share loan” is a loan made to an employee if:

(a) The sole purpose of the loan is to enable the employee to buy shares, rights or options in the company that is their employer (or is a company associated with their employer);

(b) The loan is used only for that purpose;

(c) The employee beneficially owns the shares, rights, or options throughout the term of the loan;

(d) The loan must be immediately repaid if the employee stops being the beneficial owner of any of the shares, rights, or options;

(e) The company issuing the shares has a dividend-paying policy throughout the term of the loan;

(f) The company issuing the shares, rights or options is not a qualifying company;

(g) The loan is not made under a share purchase scheme [s DC 12]; and

(h) The employer and the employee are not associated persons [see 540.35].

540.210 Employee tax returns [s CX 27]

If an employer provides an employee with assistance in the preparation of the employee’s income tax return or income statement [see 1270.75], the benefit is not subject to FBT. This applies only if the expenditure incurred by the employer would have been deductible under s DB 3 had it been incurred by the employee.

The exemption is allowed because the employee would have been entitled to an income tax deduction if the employee had incurred the expenditure.

540.215 Benefits provided by charitable organisations [s CX 25]

A benefit provided by or on behalf of a charitable organisation to an employee is excluded from the definition of fringe benefit, and is thus exempt from FBT. However, such a benefit is a fringe benefit to the extent that the employee receives it mainly in connection with their employment, where the employment consists of the carrying on by the organisation of a business whose activity is outside its benevolent, charitable, cultural or philanthropic purposes.

A “charitable organisation” is an association, fund, institution, organisation, society or trust to which s LD 3(2) or sch 32 applies [s YA 1]. Local authorities, public authorities and universities are not charitable organisations. See 1395.75 for further details.
Public Ruling 09/03

The CIR’s interpretation of when an activity will be a business activity that is outside the organisation’s benevolent, charitable, cultural, or philanthropic purposes, and when a benefit will be received by an employee mainly in connection with such activities, is set out in public ruling BR Pub 09/03 [see TIB vol 21:6 (August 2009), at 12-19], which applies from the first day of the 2008-2009 income year. The ruling provides as follows:

(a) A fringe benefit is not provided by a charitable organisation if a non-monetary benefit is received by an employee of the organisation mainly in connection with employment in an activity that either:
   (i) Carries out any of the organisation’s benevolent, charitable, cultural, or philanthropic purposes; or
   (ii) Does not constitute a profession, a trade, or an undertaking that is carried on for profit.

(b) A fringe benefit is provided by a charitable organisation if a non-monetary benefit is received by an employee of the organisation mainly in connection with employment in an activity that:
   (i) Cannot be characterised as carrying out any of the organisation’s benevolent, charitable, cultural, or philanthropic purposes; and
   (ii) Constitutes a profession, a trade, or an undertaking that is carried on for profit (even if that profit is to be applied solely for the purposes of the charitable organisation).

(c) A non-monetary benefit that is provided to an employee of a charitable organisation is received by an employee “mainly in connection with” their employment in a business activity outside the organisation’s benevolent, charitable, cultural, or philanthropic purposes, if the employee is employed:
   (i) Solely in the business activity of the organisation; or
   (ii) In both the business activity and in activities related to the charitable purpose of the organisation, and the benefit arises mainly in connection with the employment in the business activity; or
   (iii) In both the business activity and in activities related to the charitable purpose of the organisation, the benefit arises equally in connection with both the business and non-business activities, and the employee is predominantly employed in the business activities of the employer.

A charitable organisation that carries on its activities in a businesslike manner and which has the intention and record of making surpluses is not carried on “for profit”, unless the organisation’s constitution states that one of its purposes is to make a profit. As such organisations are not carried on “for pecuniary profit”, they are not carrying on a “business” for the purposes of the FBT exemption.

Activities involved in carrying out the charitable objects of a charitable organisation, or directly facilitating the carrying out of the charitable objects (such as fundraising or administrative or clerical activities) will not be treated as being business activities for the purposes of s CX 25(1). However, trading activities that are carried on to raise funds for the charity, and that are not themselves the charitable purposes of the charity, will be treated as business activities of the charitable organisation, if they satisfy the “business” test.

A benefit will be provided to an employee of a charitable organisation mainly in connection with employment in a non-charitable business activity of the organisation if the benefit arises mainly in connection with such a business activity. If an employee is employed both in activities relating to the charitable purpose of the organisation and in non-charitable business activities, it will be necessary to determine which activity the benefit arises primarily in relation to. If a benefit arises equally in connection with both the business and non-business activities carried out by an employee, the benefit will be provided mainly in connection with the activity in which the employee is predominantly employed.

If a benefit is provided mainly in connection with employment in a non-charitable business activity of an organisation, then the entire benefit will be a fringe benefit; it will not be apportioned between its relation to
charitable activities and non-charitable business activities. The use of the words “to the extent to which” in s CX 25(1) does not mean that the benefit should be apportioned.

**Example 1**

A charitable organisation has the principal purpose of providing education through a private school. The organisation is a charitable organisation for the purposes of the FBT rules, because it is not carried on for the private pecuniary profit of any individual and its funds are applied wholly or principally for charitable purposes (ie the advancement of education) within New Zealand. It provides a car to its principal for work and private use. The organisation is not liable for FBT on the benefit arising from the provision of the low interest loan to Peter. The organisation provides a car to its school principal for work and private use. The organisation is not liable for FBT on the benefit arising from the provision of the low interest loan to Peter. This is because the benefit arises in relation to Peter’s employment in the charitable organisation carrying out its charitable purposes. The organisation is not liable for FBT on the benefit arising from the provision of the low interest loan to Peter. The organisation is not liable for FBT on the benefit arising from the provision of the low interest loan to Peter. This is because the benefit arises in relation to Peter’s employment in the charitable organisation carrying out its charitable purposes. The benefit arises “mainly in connection with” those activities.

**Example 2**

A charitable organisation has the principal purpose of relieving poverty by running a food bank. The organisation is a charitable organisation for the purposes of the FBT rules, because it is not carried on for the private pecuniary profit of any individual and its funds are applied wholly or principally for charitable purposes (ie the relief of poverty) within New Zealand. It runs a shop that sells office supplies (purchased from a wholesaler) to the public. The organisation provides a car to its farm manager for work and private use. The farm manager is employed in respect of the charitable organisation carrying out its charitable purposes (ie the advancement of education). The organisation provides a car to its farm manager for work and private use. The farm manager is employed in respect of the charitable organisation carrying out its charitable purposes (ie the advancement of education). The organisation is not liable for FBT on the benefit arising from the provision of the low interest loan to Peter. The organisation is not liable for FBT on the benefit arising from the provision of the low interest loan to Peter. This is because the benefit arises in relation to Peter’s employment in the charitable organisation carrying out its charitable purposes. The organisation is not liable for FBT on the benefit arising from the provision of the low interest loan to Peter. This is because the benefit arises in relation to Peter’s employment in the charitable organisation carrying out its charitable purposes. The benefit arises “mainly in connection with” those activities.

(2) **Credit facilities not exempt**

Benefits provided by way of short-term charge facilities (eg credit cards) by a charity to an employee are not exempt from FBT if the value of the benefit for the tax year exceeds five per cent of the employee’s salary or wages for the tax year [see 540.152].

**540.220 Employees of non-resident employers [s CX 26]**

In some circumstances, benefits provided in New Zealand to the employees of non-resident employers are exempt from FBT.

Benefits received by employees who do not receive any PAYE income payments that are taxable in New Zealand in the same FBT period are excluded from the definition of “fringe benefit”. Section CX 26 excludes from the definition of “fringe benefit” benefits received by an employee who does not receive any PAYE income payments that are taxable in New Zealand in the same FBT period. any PAYE income payments are
generally taxable in New Zealand if the earner is not otherwise exempt and payments are either earned by a New Zealand resident or earned in New Zealand.

When a New Zealand resident employee works in New Zealand for a non-resident employer, the employee’s PAYE income payments are taxable in New Zealand [ss CE 1, YD 4(4)], so any fringe benefits the employee receives are subject to FBT.

When a non-resident employee works in New Zealand for a non-resident employer, the employee’s PAYE income payments may be tax exempt in New Zealand under s CW 19 or the provisions of an applicable DTA. When none of the employee’s PAYE income payments are taxable in New Zealand in an FBT period, any fringe benefits that the employee receives in that period are not subject to FBT. When some or all of the employee’s PAYE income payments are taxable in New Zealand in an FBT period, any fringe benefits that the employee receives in that period are subject to FBT.

540.225 Benefits provided by overseas branches [s CX 26]

Benefits received by an employee in any FBT period in which that employee is not liable for New Zealand income tax on any PAYE income payments received during that period are excluded from the definition of fringe benefit [see 540.220]. This applies only when the employee derives no PAYE income payments liable to New Zealand income tax in that particular FBT period. If the employee derives a PAYE income payment that is liable to New Zealand tax in a FBT period, any benefits provided during that period will not be exempt. This exclusion may affect the FBT liability of New Zealand employers that transfer employees to overseas branches.

Example 1:
Phillipa, a United States national, was appointed manager of the Bermudan branch of a New Zealand bank, Tui-Bank NZ. She was seconded to New Zealand for three months’ training before taking up her position. In that time she received PAYE income payments from Tui-Bank NZ, which are subject to New Zealand income tax under s CE 1. She received the first payment on 4 August, and the last on 27 October of the same year. Tui-Bank NZ pays FBT on a quarterly basis. Phillipa is an employee as she receives a PAYE income payment on which she is liable for New Zealand income tax. Tui-Bank NZ is accordingly her employer. On return to Bermuda, Phillipa is provided with a car, which is paid for by Tui-Bank NZ. The car is completely at her disposal, for private as well as business purposes. Whether Tui-Bank NZ is subject to FBT on the provision of a car in Bermuda depends upon when the car is provided to Phillipa. If the car is provided on her return to Bermuda on 1 November, Tui-Bank NZ is liable for FBT on that fringe benefit in the quarter ending 31 December. This is because in that quarter she received PAYE income payments liable to New Zealand income tax. She is an employee for FBT purposes in that quarter. Tui-Bank NZ does not have to account for FBT on the car in the quarter starting on 1 January of the following year because Phillipa does not receive any PAYE income payment for which she is liable for New Zealand income tax in that FBT period. Therefore, for that quarter, provision of the car is not a fringe benefit. However, if Phillipa were liable for New Zealand income tax on PAYE income payments she received, Tui-Bank NZ would have to account for FBT in that quarter.

Example 2:
Mike, a New Zealand resident, is appointed as Phillipa’s assistant manager at the Bermudan branch. Mike receives the same training in New Zealand and receives a car on the same conditions as Phillipa. When a New Zealand resident is transferred overseas to work for a branch of a New Zealand company, the analysis is different to that of a non-resident. If the New Zealand resident retains his or her resident status, a liability to New Zealand income tax continues under s BD 1. Therefore, any PAYE income payments will be subject to New Zealand income tax, and s CX 26 will not operate to exclude the fringe benefit. If the resident loses resident status (under a DTA or the residence tests in s YD 1), the exclusion in s CX 26 will apply. If Mike retains his New Zealand resident status, Tui-Bank NZ will continue to be subject to FBT on the provision of the car. If Mike loses his New Zealand resident status, Tui-Bank NZ will be subject to FBT in the same way as it is for Phillipa (in the previous example).

540.227 Benefits provided instead of allowances [ss CW 18(3), CX 19]

A benefit provided by an employer to an employee in connection with their employment is not a fringe benefit if it removes the need that would otherwise exist for the employer to pay the employee:

(a) An allowance that would have been exempt under s CW 17 [see 330.20] and would not have been paid to enable the employee to provide a benefit to another person; or

(b) An allowance reimbursing an employee for additional transport costs incurred in connection with their employment, for the benefit of the employer in travelling between home and work. The benefit is exempt only if the allowance would have been attributable to one or more of the following factors:
(i) The day or time of day when the work duties are performed;
(ii) The need to transport goods or material for use or disposal in the course of the employee’s work;
(iii) The requirement to fulfil a statutory obligation;
(iv) A temporary change in the employee’s place of work while in the same employment;
(v) Any other condition of the employee’s work;
(vi) The absence of an adequate public passenger transport service that operates fixed routes and a regular timetable for the employee’s place of work.

(c) An amount that, if it had been paid, would have been an exempt relocation payment under s CW 17B [see 330.40].

(1) Travel benefits provided to relatives of employees [s CX 19(2)]
The cost to an employer of paying for a spouse, civil union partner, de facto partner or other relative to visit an employee while the employee is temporarily working away from home is not a fringe benefit. The exemption is limited to the amount that would have been exempt from FBT (under (b) above) if the employee had made the visit home instead.

For this purpose, a “relative” is defined as a person connected with another person by:
(a) Blood relationship, within the second degree;
(b) Marriage, civil union, or de facto relationship;
(c) Marriage, civil union or de facto relationship with a person who is connected by blood relationship within the second degree to the other;
(d) Adoption as a child of the other;
(e) Adoption as a child of a person who is within the first degree of relationship to the other; or
(f) Being the trustee of a trust under which a relative has benefited or will benefit [s YA 1].

540.230 Benefits provided on employer’s premises [s CX 23] A benefit (other than free, discounted, or subsidised travel, accommodation, or clothing) is not subject to FBT if the benefit is:
(a) Provided to the employee by the employer and used or consumed by the employee on the employer’s premises or on the premises of a company in the same group of companies as the employer; or
(b) Provided to the employee by a company that is in the same group of companies as the employer and used or consumed by the employee on the employer’s premises or on the premises of the company that provides the benefit.

The premises of a person include premises that the person owns or leases and premises (other than the employer’s) on which an employee is required to perform duties for the employer, but do not include premises occupied by an employee for residential purposes. This exemption will apply mainly to free, discounted or subsidised goods or services (excluding free, discounted, or subsidised travel, accommodation, or clothing) used or consumed by the employee on the employer’s premises, including car parks [see 540.235].

540.235 Employer provided car parks [s CX 23]
Benefits used or consumed by an employee on the employer’s premises are exempt from FBT [see 540.230]. This exemption includes a car park provided to an employee where:
(a) The car park is on land or in a building owned or leased by the employer;
(b) There is an exclusive right to occupy the property; and
(c) There is a legal estate or interest in that property.

The exemption includes car parks provided on the premises of companies in the same group of companies as the employer.
The exemption also applies to a space in a public car park where the space is subject to a lease between the employer and the proprietor of the car park [see Public ruling BR 99/6 (expired 31 March 2005), TIB vol 11:8 (September 1999) at 12; TIB vol 15:6 (June 2003) at 7]. The ruling includes the examples summarised below.

**Example**  
The employer provides employees with car parks on land across the road from where the employer conducts its business. The employer leases the land under a written and enforceable lease agreement. The leased land is part of the employer’s premises. The car parks are exempt and no FBT liability arises. It does not matter that the employer carries out no business on the leased land.

The employer arranges parking at a commercial car park for three employees. No particular spaces are designated for them, but they are able to park in a reserved area in which spaces are always available for the three employees.

Although the employee’s have exclusive use of three specific spaces, the car park is not part of the employer’s premises because the employer does not have ownership or legal possession of the car parks. Specific car parks are not allocated to the employer. The car parks are not exempt and are subject to FBT.

The employer arranges parking at a commercial car park for three employees. The employer is allotted three specific parking spaces. The car park proprietor bills the employer direct. The car parks are not subject to a lease or rental agreement although the employee’s have exclusive use of three specific spaces, the car park is not part of the employer’s premises because the employer does not have ownership or legal possession of the car parks. The employer merely has the right to use them. The car parks are not exempt and are subject to FBT.

A company with many employees enters into a written and enforceable agreement to lease the whole of the top floor of a nearby car park building. Only the company’s employees can access the car parks.

**Example**  

An employer provides each of its employees with a Christmas hamper, containing food and wine, worth $250. Although the benefit is entertainment expenditure within the meaning of s DD 2, it is subject to FBT rather than the limitation rule because the benefit is not received in the course of employment and the employees can choose when to use the benefit.

Any entertainment that is received or used on the employer’s premises is exempt from FBT. Entertainment that is subject to FBT is fully deductible [see 540.355].

**540.240 Entertainment [s CX 29]**

In general, expenditure on entertainment that is subject to the limitation rule [s DD 2] is not subject to FBT but is subject to the 50 per cent deductibility restriction [see 350.30]. However, an entertainment benefit is a fringe benefit if the employee does not receive or use the entertainment benefit in the course of their employment, or as a necessary consequence of their employment duties, and either:

(a) The employee may choose when to receive or use the benefit; or
(b) The entertainment is enjoyed or consumed outside New Zealand.

**Example:**

An employer provides each of its employees with a Christmas hamper, containing food and wine, worth $250. Although the benefit is entertainment expenditure within the meaning of s DD 2, it is subject to FBT rather than the limitation rule because the benefit is not received in the course of employment and the employees can choose when to use the benefit.

**540.242 Benefits related to health or safety [s CX 24]**

A benefit that an employer provides to an employee is not subject to FBT if:

(a) It is related to the employee’s health or safety;
(b) It is aimed at hazard management in the workplace under the Health and Safety in Employment Act 1992; and
(c) It would be excluded from being a fringe benefit by s CX 23 if it were provided on the employer’s premises.

Such benefits are exempt from FBT anyway if provided on the employer’s premises [see 540.230]. Section CX 24 extends the exemption to cover health and safety benefits provided elsewhere. The exemption
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includes, for example, health checks and influenza vaccinations administered off the employer’s premises, but does not include employer-paid health insurance premiums or gym membership fees.

540.245 Distinctive work clothing [s CX 30]

Distinctive work clothing provided by employers to employees is not subject to FBT. This applies whether the clothing is given or sold at a discount to employees.

“Distinctive work clothing” is clothing that:

(a) Is worn by an employee as a uniform (or part of a uniform) that is identifiable with the employer;
(b) Is worn during or as an incidence of employment; and
(c) Is not clothing that employees would normally wear privately.

Clothing is considered to be identifiable with the employer if:

(a) A name, logo or other identification that the employer regularly uses is permanently and prominently displayed on the clothing; or
(b) The colour scheme, pattern or style of the uniform is readily associated with the employer.

Example:

A jacket, shirt, and trousers are supplied to an employee. The jacket has identification on it, but the jacket is often removed during the working day. To satisfy the “permanently” requirement, the shirt would also need to have identification on it. If only a single item of clothing is provided by an employer (eg a jersey), only that item needs to display identification to be exempt.

540.247 Business tools [s CX 21]

The private use or availability for private use of a business tool by an employee is not a fringe benefit. This exemption applies when:

(a) The business tool is provided to the employee by the employer mainly for business use; and
(b) The GST-inclusive cost of the business tool does not exceed $5,000.

A “business tool” is defined as an item that is used by an employee in the performance of their work duties and, in the absence of s CX 21, would give rise to an unclassified benefit [s YA 1]. It therefore includes items such as cell phones and laptop computers, which would otherwise give rise to an FBT liability if used privately by an employee.

A business tool may be provided mainly for business use even if it is not taken to and used on the employer’s premises, if the employee performs a significant part of their duties away from the premises.

540.250 Exemption for minor unclassified benefits [ss CX 37, RD 45]

A special exemption applies to unclassified benefits [s RD 45], which consist mainly of free or discounted goods and services [see 540.180 to 540.190]. The exemption applies as follows:

(a) If the taxable value of all unclassified benefits provided to an employee during a quarter is $300 or less, those benefits are exempt from FBT. However, this exemption does not apply if the total taxable value of all unclassified benefits provided by the employer to all employees during the last four quarters, including the current quarter, exceeds $22,500.

(b) If an employer pays FBT on an annual or income year basis and the taxable value of all unclassified benefits provided to an employee during the year is $1,200 or less, those benefits are exempt from FBT. However, this exemption does not apply if the total taxable value of all unclassified benefits provided by the employer to all employees during the year exceeds $22,500.

(c) Where the employer is accounting for FBT on an income year basis for a period of more or less than a full year (eg because the employer has commenced or ceased business), or for an income year with a non-standard balance date, the amounts of $1,200 and $22,500 are increased or decreased pro rata according to the number of days in the period.

Before 1 April 2009, the exemption thresholds were $200, $800 and $15,000.
Example 1:
Mark has two employees, Therese and John. During a quarter, Mark provided Therese with discounted goods with a taxable value of $170 and John with discounted goods with a taxable value of $340. Mark has to pay FBT on the full amount of the $340 benefit provided to John, but the $170 benefit provided to Therese is exempt because it is less than $300 (assuming the $22,500 annual threshold is not exceeded). The first $300 of John’s fringe benefit is not exempt.

Example 2:
Kiwifone Ltd provides discounted telephone and internet services to a large number of its employees, but the taxable value of the services provided to any one employee during a quarter never exceeds $300. During six consecutive quarters, the taxable values of services provided to all of its employees were as follows:

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Total for quarter</th>
<th>Total for quarter and previous three quarters</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$5,300</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>$5,400</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>$6,600</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>$5,700</td>
<td>$23,000</td>
</tr>
<tr>
<td>5</td>
<td>$4,500</td>
<td>$22,200</td>
</tr>
<tr>
<td>6</td>
<td>$5,800</td>
<td>$22,600</td>
</tr>
</tbody>
</table>

In quarter 4, Kiwifone Ltd will have to pay FBT on $5,700. This is because, even though the value of the benefits provided to any one employee does not exceed $300, the total taxable value of unclassified benefits provided in the last four quarters including quarter four to all employees ($23,000) is more than $22,500. However, FBT is not payable on the services provided in quarter five because the total taxable value in that quarter and the previous three quarters ($22,200) is less than $22,500. Will FBT be payable in quarter six?

For the sake of keeping the example simple, the issue of whether the company is liable for FBT during the first three quarters has been ignored. However, in reality the potential FBT liability for each quarter would have to be determined.

540.252 Adjustments for unclassified benefit exemptions on amalgamation [s RD 46]

When a company ceases to exist through amalgamation, or when a new company is established on amalgamation, the exemptions available under s RD 45 must be adjusted in accordance with the following paragraphs.

If the amalgamating company pays FBT quarterly, the figure of $22,500 referred to in s RD 45(2)(b) [see 540.250] must be reduced by the amount calculated under the following formula:

\[
\frac{($22,500 \times \text{number of days in the quarter after amalgamation})}{\text{days in the quarter}}
\]

If an amalgamated company (being a new company established on amalgamation) pays FBT quarterly, the figure of $22,500 referred to in s RD 45(2)(b) must be reduced by the amount calculated under the following formula:

\[
\frac{($22,500 \times \text{number of days in the quarter before amalgamation})}{\text{days in the quarter}}
\]

If the amalgamating company pays FBT annually, the figure of $22,500 referred to in s RD 45(2)(b) must be reduced by the amount calculated under the following formula:

\[
\frac{($22,500 \times \text{number of days in the year after amalgamation})}{365}
\]

If an amalgamated company (being a new company established on amalgamation) pays FBT annually, the figure of $22,500 referred to in s RD 45(2)(b) must be reduced by the amount calculated under the following formula:

\[
\frac{($22,500 \times \text{number of days in the year before amalgamation})}{365}
\]

Note: From 1 April 2009, the $22,500 threshold increased from $15,000.
540.255 Exemptions for goods sold at discount [ss CX 33, RD 42, RD 43, RD 44]

Goods sold to employees at a discount are treated as having been sold at cost (and therefore no fringe benefit arises) if:

(a) The goods are sold to an employee in the normal course of business, and  
   (i) The normal retail price of the goods is $200 or less;  
   (ii) The price of the goods to the employee is less than cost as a result of a normal staff discount; and  
   (iii) The staff discount is no more than five per cent of the normal retail price; or  
(b) The goods are sold to an employee on a day when the employer is selling identical goods at a special price to the public; and  
   (i) The normal retail price of the goods is $200 or less;  
   (ii) The price of the goods to the employee is less than cost as a result of a staff discount offered to the employee in addition to any other discount;  
   (iii) Immediately before or after the sale, a reasonable quantity of those goods is available in the open market in New Zealand; and  
   (iv) The price is at least 95 per cent of the cost of the goods, or at least 95 per cent of the price of identical goods to the public on the day of the sale, whichever is the lesser.

The normal retail price is the price at which identical goods would be sold to an arm’s length buyer in the open market in New Zealand in a sale freely offered and made on ordinary trade terms [ss RD 42, RD 43]. “Cost” means the GST-inclusive cost of the goods to a registered person. “Price” means the GST-inclusive price to a registered person [s YA 1].

The exemptions also apply if a company that is included in a group of companies sells goods to an employee of another company in the group. The sale is treated as if it were made directly from employer to employee [s RD 44].

Discounts provided to employees on goods purchased from a third party under a bulk discount arrangement, entered into between the employer and the third party, are not fringe benefits if:

(a) The third party is not associated with the employer; and  
(b) The same discount would have been available to any other group of comparable size negotiating at arm’s-length [s CX 33].

540.257 Exemption for benefits for Canterbury earthquake relief [s CZ 24]

A benefit provided by an employer to give relief to an employee from the adverse effects of one of the Canterbury earthquakes on 4 September 2010 or 22 February 2011 is exempt from FBT if the benefit:

(a) Would be a fringe benefit, if not exempted;  
(b) Is received within eight weeks following the day of the earthquake;  
(c) Is not in place of a PAYE income payment;  
(d) Is not dependent on the seniority of the employee;  
(e) Is available to a non-associated employee, if the benefit is provided to an associated employee; and  
(f) Is treated by the employer as not being a fringe benefit.

If the employer can estimate the value of the benefits provided to an employee in respect of one earthquake, the benefits will be exempt to the extent that the $3,200 exemption for that earthquake has not been used to exempt employee income under s CZ 23 [see 370.40]. A separate $3,200 exemption limit applies to each earthquake.
If the employer cannot estimate the value of the benefits provided to an employee they are treated as exempt, with no monetary limit.

Example:
Many employees of a large Christchurch employer were badly affected by the earthquake on 4 September 2010. To help these employees, on the day following the earthquake, the employer gave each of them $2,000 in cash, as well as clothing, bedding, food and water at a cost of $1,500 per employee. On 6 September 2010 the employer set up a welfare centre where its employees and their families could call in to have a hot meal, get medical attention, relax or get some sleep in a secure environment. The welfare centre was closed down on 5 December 2010. The total cost of running the welfare centre was $2,500 per week.

The $2,000 cash paid to each employee is exempt income under s CZ 23, as it is less than $3,200. The cost of the clothing, bedding, food and water provided to each employee is partially exempt. The value provided to each employee ($1,500) can be estimated, but the total of the income exemption and the fringe benefit exemption is limited to $3,200. Therefore only $1,200 of the $1,500 value is exempt. The other $300 is a taxable fringe benefit, although it may be exempt under the $300 quarterly exemption if no other unclassified benefits were received by the employee during the quarter [see 540.250]. The cost of running the welfare centre for the eight weeks following 6 September 2010 ($20,000) is also exempt under s CZ 23 because the value of the benefit to individual employees would be difficult to estimate. The cost for the ninth and subsequent weeks is not covered by the Christchurch earthquake exemption. Note, however, that if the welfare centre had been set up on the employer’s premises, the total cost would be exempt under s CX 23 [see 540.230].

540.260 Calculation of taxable value [s RD 54(1), (2)]
The taxable value of a fringe benefit is the value of the benefit (as determined under ss RD 27 to RD 46) reduced by:
(a) The amount paid by the employee for the fringe benefit; or
(b) A set percentage, when an employee is part owner of the motor vehicle.

540.265 Employee contributes towards cost of fringe benefit [s RD 54(2)-(4)]
The value of a fringe benefit is reduced by any payment made by an employee (or an associated person) for the receipt of a fringe benefit other than an employment-related loan. The value of a fringe benefit cannot be reduced by the estimated value of maintenance performed on an employer’s motor vehicle by an employee. Only monetary contributions by the employee may be deducted (eg if the employee purchased parts or oil for the vehicle, these could be deducted).

Example:
Rob has the unrestricted use of a car provided by his employer. The GST inclusive cost of the car was $32,995. During one FBT quarter, Rob personally purchased petrol, oil, and tyres for the car at a total cost of $419 (including GST). Rob was not reimbursed by his employer for these expenses. The value of the fringe benefit for the quarter (using the cost price method), is $1,650 (five per cent of $32,995). The taxable value of the fringe benefit is $1,231 ($1,650 − $419).

540.270 Employee is part owner of motor vehicle [ss RD 55, RD 56, RD 57]
When an employee is part owner of a motor vehicle that is made available by the employer for the employee’s private use, the employer’s FBT liability is reduced. The value of the fringe benefit is reduced by:
(a) 2.5 per cent of the amount contributed by the employee towards the cost of the car, if FBT is calculated on a quarterly basis;
(b) 2.5 per cent per quarter for each quarter in which the vehicle was part-owned, if FBT is calculated on an annual basis; or
(c) Ten per cent of the amount contributed by the employee towards the cost of the car, if FBT is calculated on an income year basis [ss RD 55, RD 56].

This applies also when the vehicle is part owned by a person associated with the employee. Special rules apply if the employer values the vehicle on a GST-inclusive basis [s RD 57, see 540.130].
If the vehicle is subject to FBT on an income year basis and the return period is more or less than a full year because:
Fringe Benefit Tax

(a) The employer commenced or ceased business during the year; or
(b) The employer furnished a tax return for a period longer or shorter than a normal income year after a change in balance date;

the amount by which the value of the fringe benefit is reduced is the employee’s contribution towards the cost of the vehicle multiplied by the following percentage:

\[
\frac{10\% \times \text{number of days in the period}}{365}
\]

Example:

Snowy Ltd, a close company, commenced business on 18 August. On the same day it purchased a motor vehicle for the use of Steven, one of its shareholder-employees. The GST-inclusive cost of the vehicle was $25,000. Steven agreed to contribute $5,000 towards the cost of the vehicle, as he will be able to use it privately. Snowy Ltd elected to pay its FBT on the vehicle on an income year basis. The company has a 31 March balance date. The period covered by the FBT return for the first income “year” is 226 days (assuming 28 days in February). The value of the benefit is:

\[
($25,000 \times 24\%) \times \frac{226}{365} = $3,715.07
\]

The value of the benefit is reduced by:

\[
$5,000 \times \frac{10\% \times 226}{365} = $309.59
\]

The taxable value of the fringe benefit for the first income year is therefore:

\[
$3,715.07 - $309.59 = $3,405.48
\]

If the employee has been a part-owner of the vehicle for only part of an income year, the amount to be deducted from the value of the benefit is reduced (or further reduced) on a pro rata basis depending on the number of days that the employee was a part-owner.

540.275 Benefits incidental to business travel [s CX 20]

When an incidental benefit arises to an employee as a result of their employer providing them with a travel-related benefit, the taxable value of the fringe benefit is zero [s CX 20]. This exemption applies to subsidised transport or expenditure incurred by the employer on accommodation or transport provided to an employee, if the expenditure:

(a) Relates to travel by the employee to enable them to perform their employment duties;
(b) Does not relate to leave or a vacation; and
(c) Is not increased as a result of the benefit.

540.280 FBT rate options [ss RD 26, RD 58, RD 59]

Employers who provide fringe benefits to employees are required to pay FBT [s BE 1(4), RD 26]. Employers must choose one of the following options for calculating and paying their FBT:

(a) Single rate option;
(b) Alternate rate option;
(c) Close company option (income year basis) [see 540.333]; or
(d) Small business option (annual basis) [see 540.330].

Options (c) and (d) are available only if the employer meets the eligibility criteria. The choice of method is made by providing an FBT return setting out the chosen rate. An employer’s decision to pay FBT on a quarterly basis under the single rate option or the alternate rate option cannot be changed [s RD 62(1)].

(1) Single rate option [s RD 58]

For the tax year starting 1 April 2011, employers who elect to use the single rate option must pay FBT at the rate of 49.25 per cent of the taxable value of all fringe benefits for each of the four quarters.

In the final quarter the employer may, instead of calculating FBT at the single rate, calculate it as for the alternate rate option (ie by attributing fringe benefits to the employees who received them and taxing them...
Accordingly. However, an employer may in the final quarter substitute the amount calculated under s RD 59(4) (ie the “multi-rate calculation”) for the amount calculated at the single rate.

(2) **Alternate rate option [s RD 59]**

Under the alternate rate option, employers must (for the tax year starting 1 April 2011) pay FBT in the first three quarters at either 43 per cent or 49.25 per cent of the taxable value of all fringe benefits.

For example, the employer could pay FBT at 43 per cent in the first two quarters, then at 49.25 per cent in the third quarter. For the final quarter, the employer must calculate the FBT liability for the tax year by attributing (as far as possible) the fringe benefits to the employees who received them and calculating the FBT at the rate applicable to the employee on the basis of their total income. Benefits that can’t be attributed are pooled and taxed at a flat rate [see 540.295, 540.300]. FBT paid in the first three quarters is then deducted from the total.

(3) **FBT quarters**

<table>
<thead>
<tr>
<th>Quarter</th>
<th>First day</th>
<th>Last day</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st</td>
<td>1 April</td>
<td>30 June</td>
</tr>
<tr>
<td>2nd</td>
<td>1 July</td>
<td>30 September</td>
</tr>
<tr>
<td>3rd</td>
<td>1 October</td>
<td>31 December</td>
</tr>
<tr>
<td>4th (final)</td>
<td>1 January</td>
<td>31 March</td>
</tr>
</tbody>
</table>

**540.285 Choosing the FBT rate option**

Taxpayers should consider the following factors when deciding whether to adopt the single rate or alternate rate option:

(a) The additional time and possible set-up costs to complete the multi-rate calculations.

(b) The impact of non-attributed benefits. If the business provides a number of non-attributed benefits, it should consider using the multi-rate calculation process.

(c) If employees receiving fringe benefits earn over $70,000, the business should consider using either the single rate option or the simplified multi-rate option when calculating FBT.

(d) If employees receiving fringe benefits are on lower remuneration levels, the business should consider using the multi-rate or the short-form multi-rate calculation process.

**540.295 Attributed fringe benefits [ss RD 47, RD 48, RD 49]**

When calculating the FBT liability in the final quarter using the alternate rate option, certain fringe benefits provided during the year must be attributed to the specific employees who received those benefits [s RD 47]. The following types of fringe benefit must be attributed:

(a) Motor vehicles made available for private use by an employee;

(b) Low interest loans, other than loans provided by life insurers;

(c) Subsidised transport, if the taxable value of all such benefits provided to an employee in a year is $1,000 or more;

(d) Contributions to sickness, accident or death benefit funds, if the taxable value of all such benefits provided to an employee in a year is $1,000 or more;

(e) Contributions to funeral funds, if the taxable value of all such benefits provided to an employee in a year is $1,000 or more;

(f) Specified insurance premiums or contributions to insurance funds of friendly societies, if the taxable value of all such benefits provided to an employee in a year is $1,000 or more;

(g) Contributions to employee superannuation schemes, if the taxable value of all such benefits provided to an employee in a year is $1,000 or more;
(h) Unclassified benefits, if the taxable value of all such benefits received by the employee during the year is $2,000 or more.

If one of these benefits is available to more than one employee during a quarter (or income year, in the case of shareholder-employees paying FBT on an income year basis), the benefit must be attributed to the employee who mainly uses or receives the benefit. This will apply mainly to the private use of motor vehicles. If the employer cannot decide which employee mainly uses or receives the benefit, the fringe benefit must be pooled [s RD 48].

Fringe benefits that fall under the $1,000 and $2,000 thresholds specified above may, at the employer’s option, be either attributed or pooled. However, if any such benefits are attributed, all benefits in the same category must be attributed.

There is a special rule that subsidised transport, even if the taxable value exceeds $1,000 a year, can be pooled provided that all employees have the same or a similar entitlement to the benefit. All fringe benefits that do not have to be attributed (referred to as non-attributed fringe benefits) are pooled [s RD 49].

540.300 Calculating FBT on attributed fringe benefits [ss RD 50, RD 51, RD 52, RD 63]

The year-end FBT calculation using the alternate rate option involves three steps:

(a) Calculate each employee’s all-inclusive pay;
(b) Calculate the tax on each employee’s all-inclusive pay; and
(c) Calculate the employer’s FBT liability for each employee.

(1) Calculate each employee’s all-inclusive pay [s RD 51]

At the end of the year (31 March), for each employee to whom a fringe benefit is attributed, the employer must calculate the employee’s “all-inclusive pay” using the following formula:

\[
\text{All-inclusive pay} = \text{Cash pay} - \text{tax on cash pay} + \text{taxable value of all fringe benefits}
\]

Where:

“Cash pay” is the employee’s total gross employment earnings for the year [see 540.305].

“Tax on cash pay” is tax calculated on cash pay at the relevant personal tax rates for the tax year. The rates (as per sch 1, part A, cl 1) for 2011-2012 are:

<table>
<thead>
<tr>
<th>Cash pay for year</th>
<th>Tax rate</th>
<th>Cumulative tax total</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 - $14,000</td>
<td>10.5%</td>
<td>$1,470.00</td>
</tr>
<tr>
<td>$14,001 - $48,000</td>
<td>17.5%</td>
<td>$7,420.00</td>
</tr>
<tr>
<td>$48,001 - $70,000</td>
<td>30.0%</td>
<td>$14,020.00</td>
</tr>
<tr>
<td>Over $70,000</td>
<td>33.0%</td>
<td>-</td>
</tr>
</tbody>
</table>

The rates from 2011-2012 are:

<table>
<thead>
<tr>
<th>Cash pay for year</th>
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</tr>
<tr>
<td>Over $70,000</td>
<td>33.0%</td>
<td>-</td>
</tr>
</tbody>
</table>

“Taxable value of all fringe benefits” is the taxable value of all fringe benefits attributed to the employee in the tax year and all fringe benefits attributed to a person associated with the employee in the income year, if that person does not receive the fringe benefits as an employee (eg a shareholder who is not an employee).
(2) **Calculate the tax on each employee’s all-inclusive pay [s RD 50]**

The tax on each employee’s all-inclusive pay is calculated using the rates below (as per sch 1, part C, table 1) for 2011-2012.

<table>
<thead>
<tr>
<th>All-inclusive pay</th>
<th>Tax rate</th>
<th>Cumulative tax total</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 - $12,530</td>
<td>11.73%</td>
<td>$1,469.77</td>
</tr>
<tr>
<td>$12,531 - $40,580</td>
<td>21.21%</td>
<td>$7,419.17</td>
</tr>
<tr>
<td>$40,581- $55,980</td>
<td>42.86%</td>
<td>$14,019.61</td>
</tr>
<tr>
<td>Over $55,981</td>
<td>49.25%</td>
<td>-</td>
</tr>
</tbody>
</table>

(3) **Calculate the employer’s FBT liability for each employee [s RD 50(2)]**

The employer’s FBT liability for each employee on the value of attributed fringe benefits is taxed on all-inclusive pay minus tax on cash pay.

Employers who choose to pay FBT at the rate of 42.86 per cent in accordance with s RD 52(3)(a), on fringe benefits attributed to shareholder-employees and employees who receive attributed income must, when they apply the alternate rate option in the following tax year, deduct from the amount determined under step three the amount of FBT so paid.

(4) **Employers who cease to employ [s RD 63]**

A person who stops employing staff and does not intend to replace them during the tax year must pay FBT under the alternate rate option in the quarter in which the employer stops employing staff. However, this does not apply if the employer continues to provide a fringe benefit to a former employee.

Employers who cease to employ staff can calculate FBT at the 49.25 per cent rate rather than making the FBT calculation. If this option is used, FBT is calculated at the applicable rate on all benefits provided from the start of the tax year to the date the employer stop employing staff, with credit given for any FBT already paid.

Example (based on 2011-2012 tax rates):

An employer stopped trading on 22 November and ceased to employ staff. In the quarters ended 30 June and 30 September, the employer had provided fringe benefits with a taxable value of $5,234 and $4,897 respectively and paid FBT on those benefits at the rate of 43 per cent (under the alternate rate option). The taxable value of fringe benefits provided between 1 October and 22 November was $2,957. The employer decided to pay FBT at the 49.25 per cent rate in the final return, rather than work out the FBT calculation. The total value of fringe benefits provided since the start of the tax year is $13,088 ($5,234 + $4,897 + $2,957). FBT on this amount at the rate of 49.25 per cent is $6,446. FBT paid in the first two quarters is $4,356 [(5,234 + $4,897) × 43%]. FBT payable in the final return is $2,090 ($6,446 - $4,356).

540.305 **Meaning of cash pay [s RD 51]**

If an employee is a major shareholder of a close company (a shareholder with 10 per cent or more of the control of the company), “cash pay” is the cash pay (ie pay that is received in cash form) of an employee, for the income year in which a fringe benefit is attributed, that is paid to the employee by the employer or a related employer, and includes:

(a) A dividend and interest derived by the employee from their employer; and
(b) A dividend and interest derived by the employee from a related employer.

If the employee is not a major shareholder of a close company, “cash pay” is the cash pay of the employee, for the tax year in which the fringe benefit is attributed, that is paid to the employee by the employer or a related employer.

“Pay” means:

(a) Salary or wages;
(b) Salary or wages derived by a shareholder-employee from a close company, that is not treated as a source deduction payment (ie does not have PAYE deducted from it);
(c) An amount attributed under s GB 29 (personal services income);
(d) Extra pays; and
(e) Schedular payments [s RD 51(6)].

A “related employer” is a branch or division of an employer, or a person associated with the employer.

540.310 Simplified alternate rate option [RD 50(5)]

Instead of using the alternate rate option [see 540.300], the employer may simply pay FBT at the rate of 49.25 per cent on the taxable value of all attributed fringe benefits.

Depending on the employee’s annual remuneration, this option may result in the employer paying more FBT than necessary, but it has the advantage of lower compliance costs because a “square up” calculation is not required in the following year. Each employer will need to compare the relative costs and benefits to see which alternative is better for them.

540.315 Fringe benefits attributed to shareholder-employees [s RD 52]

If, at the time it would normally complete its fourth quarter FBT return, an employer does not have sufficient information to calculate its FBT liability on attributed fringe benefits, two options are available to the employer. These options are aimed at employers who have not completed their annual accounts by 31 May and therefore have not determined the amount of shareholder-employee remuneration for the year or the amount of income to be attributed to an employee under s GB 29. Section RD 52 does not apply to employers who pay their FBT on an income year basis.

The two options are:

(a) The employer is not required to calculate FBT on attributed fringe benefits in the year the fringe benefits are attributed to those employees outlined above. Instead, the employer pays FBT at the rate of 42.86 per cent on the taxable value of the fringe benefits in the tax year they are attributed, and then calculates FBT on the attributed fringe benefits in the next tax year in respect of those employees. For this purpose, cash remuneration is treated as being cash remuneration in the income year following the income year in which the amount was derived or attributed [s RD 51(5)].

(b) The employer can opt to pay FBT at the rate of 49.25 per cent on the taxable value of fringe benefits attributed for the tax year. In this case, FBT on the attributed fringe benefits does not have to be calculated in the following tax year.

540.320 Calculating FBT on pooled fringe benefits [ss RD 47, RD 48, RD 49, RD 53]

The following fringe benefits must be pooled:

(a) Subsidised transport, if the taxable value of all such benefits in a year is less than $1,000 per employee and the benefit has not been attributed;
(b) Contributions to sickness, accident or death benefit funds, if the taxable value of all such benefits in a year is less than $1,000 per employee and the benefit has not been attributed;
(c) Contributions to funeral funds, if the taxable value of all such benefits in a year is less than $1,000 per employee and the benefit has not been attributed;
(d) Specified insurance premiums or contributions to insurance funds of friendly societies, if the taxable value of all such benefits in a year is less than $1,000 per employee and the benefit has not been attributed;
(e) Contributions to employee superannuation schemes, if the taxable value of all such benefits in a year is less than $1,000 per employee and the benefit has not been attributed;
(f) Unclassified benefits, if the taxable value of all such benefits received by the employee during the year is less than $2,000 and the benefit has not been attributed;
(g) Subsidised transport with a taxable value exceeding $1,000 per employee a year that an employer (who meets the specified criteria) has chosen to pool;

(h) Any fringe benefits that cannot be attributed to a particular employee;

(i) Any fringe benefits provided to a former employee;

(j) Loans owing by policyholders or their associates to life insurers.

FBT is calculated at 49.25 per cent on pooled fringe benefits provided to major shareholders and their associates (unless the associate receives the fringe benefit in their own right as an employee). FBT is calculated at 42.86 per cent on all other pooled fringe benefits.

A “major shareholder” is a shareholder in a close company who owns or has the power to control (directly or indirectly), 10 per cent or more of the ordinary shares or the voting rights of the company, or has 10 per cent or more control of the company [s YA 1].

A “close company” is a company controlled by five or fewer individual shareholders.

540.325 Returns [ss RA 15, RD 63, RM 9; TAA, ss 46B, 46C]

Employers who provide fringe benefits must provide Inland Revenue with periodic FBT returns, setting out details of the fringe benefits provided to each employee during the period and a calculation of the amount of FBT payable. Details of the returns required are:

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<thead>
<tr>
<th>Calculation option</th>
<th>Return period</th>
<th>Due date</th>
<th>Return form to use</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single rate or alternate rate option</td>
<td>Quarter ended: 30 June, 30 September, 31 December, 31 March</td>
<td>20 July, 20 October, 20 January, 31 May</td>
<td>IR420</td>
</tr>
<tr>
<td>Close company option</td>
<td>Income year</td>
<td>Terminal tax date</td>
<td>IR421</td>
</tr>
<tr>
<td>Small business option</td>
<td>Tax year</td>
<td>31 May</td>
<td>IR422</td>
</tr>
</tbody>
</table>

Any FBT payable must be paid by the same due date as for the return [s RA 15].

FBT returns can be filed electronically using Inland Revenue’s eFBT service, which can be accessed through Inland Revenue’s website. The advantages of filing returns electronically are that the calculations are made automatically by the system, the return arrives at Inland Revenue instantaneously, and refunds are paid out earlier than for paper-based returns.

An employer who does not provide any fringe benefits during a quarter must provide Inland Revenue with a nil return. Nil returns are due on the same dates as if there were an FBT liability. However, Inland Revenue may exempt employers or classes of employers from the need to file nil returns [TAA, s 46B(5)].

If an employer discovers an error in an FBT return that has already been filed, the error can be corrected informally (in the case of small errors) by writing to Inland Revenue, or formally by issuing a notice of proposed adjustment (NOPA) [see 260.20].

A person who stops employing and does not intend to re-employ staff during the tax year must furnish their final FBT return and pay any FBT due within two months following the end of the quarter in which employment ceased. An employer who continues to provide a fringe benefit to a former employer must continue to provide FBT returns as normal [s RD 63; TAA, s 46B(6)].

540.330 Annual basis [s RD 61]

An employer may pay FBT on an annual basis (small business option) for fringe benefits provided to employees other than shareholder-employees in a tax year if:

(a) Total PAYE and ESCT for the preceding tax year were no more than $500,000; or

(b) The employer was not an employer in the preceding tax year.

If an employer ceases business and begins a new business, or operates two or more businesses simultaneously, the gross tax deductions and ESCT relating to all businesses carried on by that employer must not exceed $500,000 for the preceding tax year.
An employer meeting the criteria may choose to use the annual basis by giving notice to the CIR, either in writing or by telephone, stating the first tax year to which the election applies. Where the employer was an employer in the previous tax year, the notice must be given to Inland Revenue by 30 June in the tax year to which the election first applies.

**Example 1:**
An employer (whose gross tax deductions and ESCT during the previous year were less than $500,000) wishes to pay FBT on an annual basis for the first time during the year beginning 1 April 20X1. The employer must provide a written election to Inland Revenue on or before 30 June 20X1.

If the employer was not an employer in the previous tax year, the notice must be given to Inland Revenue by the last day of the quarter during which the employer commenced employing staff.

**Example 2:**
A new employer who wishes to pay FBT on an annual basis first employed staff on 1 August 20X1. The employer must provide a written election to Inland Revenue on or before 30 September 20X1.

An employer who elects to pay FBT on an annual basis must pay FBT on the taxable value of fringe benefits provided during the tax year to all employees other than shareholder-employees. FBT is calculated in the same way as if it was being calculated on a quarterly basis. FBT is paid at either the flat rate of 49.25 per cent on all fringe benefits, or by attributing benefits to individual employees under ss RD 50 and RD 53.

**540.333 Income year basis [ss RD 60, RD 62]**
A close company may elect to pay FBT on fringe benefits provided to shareholder-employees on an income year basis (close company option) if:

(a) The total PAYE and ESCT for the preceding income year were no more than $500,000; or
(b) The company was not an employer in the preceding income year.

If an employer ceases business and begins a new business, or operates two or more businesses simultaneously, the PAYE and ESCT relating to all businesses carried on by that employer must not exceed $500,000.

An employer meeting the criteria may elect to use the income year basis by giving notice to the CIR, either in writing or by telephone, stating the first year to which the election applies. If the employer is a new employer, notice must be given by the last day of the quarter in which the employer begins employing staff. If the employer is not a new employer, notice must be given by the last day of the first quarter of the relevant income year.

**Example:**
If a close company, which meets the under-$500,000 criterion, was an employer in the previous income year and has a 30 June balance date, wishes to commence paying FBT on an income year basis in its 20X1 income year, the election must be made by 30 September 20X1.

When an employer who has been paying FBT on a quarterly basis elects to pay it on an income year basis, a calculation must be made under s RD 59 [see 540.325] for the period:

(a) Beginning immediately after the end of the last full tax year for which the employer paid FBT on a quarterly basis; and
(b) Ending immediately before the start of the first income year for which the election applies [s RD 62(5)]

Employers that elect to pay FBT on an income year basis calculate and pay their FBT annually on fringe benefits provided to shareholder-employees during the company’s income year. FBT is paid either at the flat rate of 49.25 per cent on the taxable value of all fringe benefits, or by attributing benefits to individual employees under ss RD 50 and RD 53.

An employer who has elected to use the annual basis or income year basis but ceases to meet the criteria to use these methods (eg because gross tax deductions in a subsequent tax year exceed $500,000) must furnish
returns and pay FBT on a quarterly basis for the tax year in which it ceases to meet the criteria [s RD 62(2)].

An employer may change from the annual basis or income year basis to the quarterly basis at any time by providing Inland Revenue with a written election. If the first day of a quarter does not coincide with the last day of the last return filed by the employer on an income year basis, a return is required for the broken period [s RD 62(3), (4)].

540.335 Record keeping [TAA, s 22(2), (2B), (5)]

Any employer to whom the FBT rules apply, or any person who provides a fringe benefit, must keep in New Zealand sufficient records in the English language to enable Inland Revenue to readily ascertain every fringe benefit (and the taxable value of every fringe benefit) provided by the employer.

Those records must include, among other things, details of the recipient of the benefit, the occasion when it was provided, and the amount (if any) paid by the employee for the benefit. The records must be retained for at least seven years after the end of the income year to which they relate. The CIR may extend the seven-year period by a further three years provided notice is given to the taxpayer before the expiry of the seven-year retention period.

540.340 Assessment [TAA, s 93]

Inland Revenue may make an assessment of the amount of FBT that it considers ought to be imposed on any person chargeable with FBT. The person so assessed is liable to pay the FBT assessed unless they can establish by challenging the assessment that the assessment is excessive or they are not chargeable with FBT [TAA, s 93]. This provision is aimed at taxpayers who have an FBT liability but fail to file returns or file false returns.

An assessment may not be challenged in Court, and the assessment is deemed to be correct, unless the challenge procedures in Part 8A of the TAA are followed [TAA, s 109]. A taxpayer who does not follow these procedures within the specified time limits loses all right to legally challenge the assessment. Inland Revenue must provide the person assessed with a notice of assessment [TAA, s 111, see 260.70].

Inland Revenue may at any time alter or amend an assessment to ensure its correctness, even if the tax already assessed has been paid. If a new or increased liability results from the amended assessment, Inland Revenue must give notice of it to the taxpayer [TAA, s 113].

540.345 Penalties and interest

The following penalties may apply to persons liable to pay FBT:

(a) Late payment penalty [TAA, s 139B, 1110.40];
(b) Shortfall penalty for lack of reasonable care, unacceptable tax position, etc; [see 1110.85 to 1110.165]
(c) Criminal penalties [see 1110.220 to 1110.270]; and
(d) Use-of-money interest [see 1110.290, 1110.295].

The late filing penalty does not apply to FBT returns.

540.350 Anti-avoidance rule [ss BG 1, GA 2, GB 31, YA 2, YA 3]

If an arrangement has been entered into, with a purpose or effect (not being incidental) to defeat the intent and application of any FBT rules, Inland Revenue may deem any party to that arrangement to be an employer and any person or persons to be employees. Any benefit obtained by the deemed employees and provided by the deemed employer is considered to be a benefit provided by virtue of an employment relationship, and the FBT rules apply accordingly for the period of the arrangement [s GB 31].

The definition of “income tax” in s YA 2 includes FBT for the purposes of ss BB 3 and BG 1. This means that the CIR can invoke the general anti-avoidance rules [s BG 1] to counteract an avoidance arrangement involving FBT.
If an arrangement involving FBT is void under s BG 1, the CIR is able to adjust the amount of excluded income under s CX 3 of any person affected by the arrangement, so as to counteract any tax advantage obtained. In adjusting excluded income, the CIR may consider:

(a) The amount of excluded income that, in the CIR’s opinion, the person would have had or is likely to have had if the arrangement had not been entered into; or
(b) The amount of excluded income that, in the CIR’s opinion, the person would have had if they had been allowed the benefit of some or all of the excluded income derived by any other person or persons as a result of the arrangement.

If an amount of excluded income is included in the income of a person under this adjustment, that amount cannot be included in the income of any other person [s GA 2].

540.355 Deductibility [ss DA 1, DA 3, EF 1]

FBT is deductible for income tax purposes to the extent that it is incurred by the employer in deriving their assessable income or excluded income, or in the course of carrying on a business. Similarly, the expenditure incurred by the employer in providing a fringe benefit is deductible if it relates to deriving their assessable or excluded income, or in carrying on a business [s DA 1]. FBT paid overseas is also deductible for income tax purposes if the general permission [s DA 1] is satisfied.

Although FBT is a form of income tax, the prohibition on the deduction of income tax in s DB 1(1)(a) does not apply to FBT because FBT is specifically excluded from the definition of income tax for the purpose of the prohibition — see the definition of “income tax” in s DB 1(2).

FBT is deductible in the income year in which the fringe benefits (to which the FBT relates) were provided or granted, not necessarily in the year the FBT is due and payable [s EF 1].

Example:

FBT paid on 28 May 20X1 in respect of fringe benefits provided to employees during the quarter ended 31 March 20X1 will be deductible in the income year ended 31 March 20X1 (assuming the employer has a standard balance date).

A company paying FBT on a quarterly basis and having a non-standard balance date may have an FBT quarter spanning two income years. The FBT on benefits provided by the company before the end of the earlier income year is deductible in that earlier income year. The FBT on benefits provided in the later income year is deductible in that later income year.

540.360 GST payable on fringe benefits [GSTA 1985, ss DB 2, 21I, 23A]

When an employer who is registered for GST provides an employee with a fringe benefit, the employer is deemed to have made a supply of goods and services in the course of a taxable activity. The supply is treated as taking place at the time the fringe benefit is provided [GSTA, s 211].

The GST on the fringe benefit (one ninth of the value of the benefit) is accounted for in the FBT return and must be paid at the same time as the FBT to which the return relates [GSTA, s 23A]. The value of the supply is the taxable value of the fringe benefit reduced by any contribution made by the employee towards the cost of that fringe benefit.

No GST is payable if the fringe benefit is exempt (eg a low-interest loan) or zero-rated (eg overseas travel), or if a registered person provides the benefit in the course of making an exempt supply (eg a company car provided to a life insurance salesperson) [see 580.126].

The GST payable on fringe benefits is deductible for income tax purposes [s DB 2(2)].
# Chapter 580

## Goods and Services Tax

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580.05 Summary of the GST regime

GST is an indirect consumption tax imposed at the rate of 15 per cent (12.5 per cent prior to 1 October 2010) on most goods and services supplied in New Zealand by registered persons in the course of carrying on a taxable activity. It is also imposed on goods other than fine metal imported into New Zealand for manufacturing or home consumption. Some supplies are specifically exempted from GST, while others are zero-rated. Supplies which are exempt from GST include financial services, donated goods and services sold by non-profit organisations, residential rental accommodation, the sale of a property which has been used for residential rental accommodation for at least five years, and the supply of fine metals (pure gold, silver, and platinum). A reverse charge mechanism applies to imported services under certain circumstances. This results in the importer of the services being liable for GST on the value of those services.

Supplies which are zero-rated include exported goods, goods not situated in New Zealand at the time of supply, taxable activities sold as going concerns to registered persons, new fine metal supplied by a refiner to a dealer, international transportation of passengers and goods, services in connection with land or moveable personal property situated outside New Zealand, services provided to non-residents, and services physically supplied outside New Zealand.

GST operates on a credit offset basis. It is charged on all taxable supplies whether made by importers, manufacturers, wholesalers or retailers. At each stage along this chain, businesses making taxable supplies must account for GST on each supply. At the same time, they are able to offset the GST that they pay on the goods and services that they receive. Therefore, the burden of GST — this privilege is reserved for the final consumer of the good or service. Exempt supplies are completely excluded from the GST regime — no GST is charged on them and GST cannot be claimed back on the expenses incurred in supplying them. However, with zero-rated supplies, no GST is charged on the supply, but GST can be claimed back for expenses incurred in making the supply.
GST is charged only on supplies made by registered persons. A person must be registered for GST if they carry on a taxable activity and their total taxable supplies in any 12-month period exceeds, or is expected to exceed, $60,000 (formerly $40,000, before 1 April 2009). Persons with an annual turnover of less than $60,000 have the option of registering for GST, provided they are carrying on a taxable activity. The purpose of this threshold is to reduce compliance and administration costs by excluding part-time traders, non-profit organisations, and hobbyists whose GST liabilities would be insignificant.

A taxable activity is any activity carried on continuously or regularly, whether or not for profit, which involves the supply of goods and services for consideration. It includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club. The activities of public and local authorities are specifically included. Private recreational pursuits or hobbies, employment (including engagement as a company director), and activities which involve the making of exempt supplies are not taxable activities.

Registered persons are required to provide returns and pay the tax owing (if any) within one month after the end of their taxable period, except in the case of returns otherwise due on 31 December which are not required until 15 January. The normal taxable period is two months, although if taxable supplies are less than $500,000 per year (formerly $250,000, before 1 April 2009), a person can apply to file six-monthly returns. Where taxable supplies have been less than $500,000 per year, but increase above that threshold, the CIR has the discretion to allow the registered person to remain on a six-monthly filing basis. Any person can apply to file returns on a monthly basis. In addition, any person whose annual taxable supplies exceed or are likely to exceed $24 million must file monthly returns.

There are three ways in which registered persons can account for GST — on the invoice basis, the payments basis, or the hybrid basis. The invoice basis is the default method and must be used by all registered persons unless they apply to use, and meet the criteria for, either of the other two methods. Both output tax (tax on sales, or outputs) and input tax (tax on supplies received, or inputs) must be accounted for in the taxable period in which the supply is made. The payments basis may be used by persons whose taxable supplies do not exceed $2 million per year (formerly $1.3 million, before 1 April 2009), local authorities listed in an Order in Council, and non-profit bodies, and also in circumstances where it would be appropriate for the person to use the payments basis because of the nature, volume and value of the taxable supplies made, and the nature of the person’s accounting system. Under the payments basis, GST is accounted for in the taxable period in which the person receives payment for taxable supplies made, and makes payment for taxable supplies received. The hybrid basis may be used by any registered person. As its name suggests, the hybrid basis is a combination of the other two — GST on sales is accounted for on an invoice basis, while GST on purchases is accounted for on a payments basis.

The amount of tax payable for each taxable period by registered persons is the difference between their output tax and input tax for that period. If the amount of input tax exceeds output tax, the registered person receives a GST refund. Output tax is the tax on all taxable supplies made by the person. Input tax is the tax charged to the person in respect of all taxable supplies they receive. A number of adjustments must be made to input tax and output tax when completing the return (for example for private use of business assets, entertainment expenditure, bad debts recovered, barter transactions, and changes in the accounting basis used).

A credit for input tax can only be claimed if the registered person holds a tax invoice, or a debit or credit note. A tax invoice must be provided by all registered persons making a taxable supply in excess of $50. Where the price of the supply is between $50 and $1,000, a simplified form of tax invoice can be used. Inland Revenue may approve the use of modified tax invoices in special cases, or may even exempt a supplier from issuing tax invoices altogether. Invoices may be transmitted electronically provided they contain the necessary information.

580.07 Supplies liable for GST [s 8]

In order for a supply to be liable for GST, it must meet all of the following conditions. The supply must:

(a) Be a supply of goods and services;

(b) Not be an exempt supply;
(c) Be made in New Zealand;
(d) Occur on or after 1 October 1986;
(e) Be made by a registered person; and
(f) Be made in the course or furtherance of a taxable activity.

These conditions are explained in more detail in subsequent paragraphs.
The flowchart summarises the decision process necessary to determine whether a particular transaction or event is a supply chargeable with GST (a taxable supply). However, the flowchart is only a summary and
must be used in conjunction with the legislation and relevant statutory definitions of terms such as “supply”, “exempt supply”, “taxable activity”.

Supplies which meet all of the above conditions are taxed at the rate of 15 per cent (12.5 per cent prior to 1 October 2010) unless they are zero-rated supplies [see 580.30]. Zero-rated supplies are taxed at the rate of zero per cent, that is, no tax is imposed [s 11].

GST is charged on the value of the supply [see 580.60].

For GST purposes, all monetary amounts must be expressed in New Zealand currency [s 77].

**580.10 Taxable supplies [ss 2, 5]**

A taxable supply is any supply of goods and services which is charged with GST under s 8, including zero-rated supplies. An exempt supply is not charged with GST and is therefore not a taxable supply.

“Supply” is broadly defined to include all forms of supply.

“Goods” means all kinds of personal or real property, except choses in action and money. “Goods” excludes a product that is transmitted by a non-resident to a resident by means of a wire, cable, radio, optical or other electromagnetic systems, or by means of a similar technical system.

“Services” means anything which is not goods or money. Services therefore includes choses in action and products transmitted electronically.

Goods and services together include everything except money. A supply of anything other than money is therefore potentially liable to be charged with GST [see TES 5 (June 2003) 65].

The GST treatment of PAYE intermediaries [see 1080.80] follows the general rules. Such things as the provision of the trustee structure, establishing and maintaining customer accounts and the clearing and settlement processes are likely to be taxable supplies. Other services such as tax deposits made with Inland Revenue may be a debt security and, therefore, a GST-exempt financial service.

The payment to a local authority of a financial contribution, in the form of money or land, under the Resource Management Act 1991, or a development contribution under the Local Government Act 2002, is deemed to be made in consideration for a supply of goods and services by the local authority. Where the contribution is in money, it is subject to GST at the standard rate of 15 per cent (12.5 per cent prior to 1 October 2010). This allows the registered person making the contribution to claim back the GST amount as an input tax deduction. Where the contribution is in the form of land, both the supply by the local authority and the supply of the land is zero-rated. This treatment avoids the difficulty of ascertaining a value for the land.

Sheriffs executing writs of sale are not obliged to account to the CIR for outstanding GST until they have paid their own expenses and sums owed to any creditors with security over the assets. They are carrying out their powers as officers of the Court and are not acting as agents for the party who obtained the writ: *Sheriff of the New Zealand High Court v Commissioner of Inland Revenue* (1996) 17 NZTC 12,599 (HC).

In *TRA Case T2* (1997) 18 NZTC 8,007, a wife (who was in partnership with her husband in a farming business) was held not to be liable for GST on her share of income derived by her husband from illegal activities carried out on the farm because she had no knowledge of these activities and had not consented to them. The illegal activities were not part of the usual activities of the partnership business.

In *TRA Case T13* (1997) 18 NZTC 8,080, the owner of three taxis was held not to be liable to account for GST on the 50 per cent share of takings earned by relief drivers. The relief drivers were, on the facts of this particular case, independent contractors who derived the income on their own account, not as employees of the taxi owner. This finding was followed in *TRA Case U9* (1999) 19 NZTC 9,077.

In *Commissioner of Inland Revenue v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 (CA), payments totalling $85 million made by the Crown to an oil refining company as an inducement for the company to remain in operation were held not to be for a supply for GST purposes. The payments were received in the course of a taxable activity but they were not in consideration for any supply made by the company. The Court stated that it is fundamental to the GSTA that the tax is levied on, or in respect of, supplies. It is not a tax on receipts or turnover. The decision contains a useful analysis of the meaning of “consideration” for GST purposes.

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In *TRA Case T22* (1997) 18 NZTC 8,124, a payment by the Crown to the owner of a marron (freshwater crayfish) farming business, in settlement of a dispute between the parties, was held not to be for a supply of goods and services to the Crown and was therefore not liable to GST. The dispute arose because a change in Government policy rendered the marron farming business valueless. After negotiation, the Crown paid the owner of the business $1,366,377 in settlement of all claims. Inland Revenue subsequently assessed this amount for GST. The TRA rejected all three grounds relied on by the CIR in making the assessment:

(a) The payment by the Crown for the surrender of the fish farming licence could not be for a supply because, at the time of settlement, the licence had no value.

(b) The objector did not make a supply of goods or a service by ceasing to carry on its business of marron farming. The objector’s business was rendered inoperative by the actions of the Crown.

(c) No part of the payment was for the value of the marron which had to be destroyed.

The payment was a global offer intended to persuade the objector not to pursue claims for damages. The CIR’s alternative argument — that the objector’s forbearance to sue amounted to a supply — was contrary to established law in *TRA Case S77* (1996) 17 NZTC 7,483, and the CIR was unable to distinguish that case.

In *TRA Case U37* (2000) 19 NZTC 9,353, the Authority held that an inducement to enter into a lease is a payment made in the course of a taxable activity and therefore subject to GST.

In *Pacific Trawling Ltd v Chief Executive of the Ministry of Fisheries* (2005) 22 NZTC 19,204 (HC), Miller J found that deemed value payments made by fishers to the Ministry of Fisheries to cover the value of unintended catches of species for which quota is not held (by-catch), are payments in respect of a taxable supply.

In an interpretation statement *Treaty of Waitangi Settlements — GST Treatment*, the CIR states that settlement payments (whether cash or non-cash), made by the Crown to Maori claimant groups, for wrongs done in the past, are not consideration for a supply of goods and services and therefore are not subject to GST. Nor does compensation fall within the meaning of “grant or subsidy” and so will not be deemed to be consideration for the supply of goods and services under s 5(6D) [see TIB vol 14:9 (September 2002) at 50-59]. The CIR has also stated that claimant funding (provided by the Crown through the Office of Treaty Settlements) for claimants’ negotiation costs is not subject to GST [see TIB vol 18:11 (December 2006) at 37-39].

**580.12 Special forms of supply [s 5]**

(1) **Sale in satisfaction of debt (repossessed goods) [s 5(2)]**

When goods securing a debt are sold by a creditor in satisfaction of the debt owing by the debtor, the goods are deemed to be supplied by the debtor in the course of a taxable activity unless certain conditions are met [see 580.14].

(2) **Cessation of registration [ss 5(3), (3A)]**

When a person ceases to be registered for GST, any goods and services used in the taxable activity and not sold prior to deregistration are deemed to be supplied in the course of the taxable activity at the time registration ceases [see 580.84].

(3) **Door to door sales [s 5(4)]**

A sale covered by the Door to Door Sales Act 1967 is not a supply of goods and services until the expiry of the statutory period within which the sale may be cancelled.

(4) **Layby sales [s 5(5)]**

A layby sale is not a supply of goods and services until the goods are delivered, and the property in the goods is transferred, to the buyer. If a layby sale is cancelled, a supply is deemed to take place to the extent of any amount retained or recovered from the buyer to recoup the selling costs [s 10(9)].
(5) **Public authority services [s 5(6)]**

Goods and services provided by public authorities and paid for by the Crown are taxable supplies. The value of the supply is the amount brought to charge by the public authority as revenue from the Crown for the supply of outputs [s 10(10)].

(6) **Transport registration and licence fees [s 5(6A)]**

Registration and licence fees paid to the Land Transport Safety Authority under the Transport (Vehicle and Driver Registration and Licensing) Act 1986 are deemed to be consideration for taxable supplies.

(7) **New Zealand Fire Service Commission levies [s 5(6AB)]**

Levies paid to the NZ Fire Service Commission, other than amounts that are a penalty surcharge or interest, are deemed to be consideration for taxable supplies [see s 155 of the Taxation (Base Maintenance and Miscellaneous Provisions) Act 2005, clarifying this treatment, with retrospective effect from 1 October 1986].

(8) **Waste disposal levies [s 5(6AC)]**

The Waste Minimisation Act 2008 imposes three types of levy obligations. These are:

(a) Payment of the waste disposal levy by a user of a waste disposal facility to the operator of that facility;
(b) Payment of the levy by the operator to the Secretary for the Ministry of the Environment (represented by the levy collector); and
(c) Payment made by the Secretary for the Ministry to funding recipients and for other amounts set out in s 30 of the Waste Minimisation Act 2008.

Waste disposal levies payable at each step are treated as consideration for a supply of services in the course of carrying on a taxable activity. They are, therefore, subject to GST and give rise to input tax credits.

(9) **Road user charges [s 5(6B)]**

Road user charges paid to the Land Transport Safety Authority under the Road User Charges Act 1977 on or after 26 April 1993 are deemed to be consideration for taxable supplies.

(10) **Electoral deposits [s 5(6C)]**

Electoral deposits paid under the Electoral Act 1993 or the Local Elections and Polls Act 1976 are deemed to be consideration for taxable supplies. The supply takes place if and when the deposit is forfeited.

(11) **Government grants or subsidies [ss 5(6D), (6E)]**

A payment in the nature of a grant or subsidy made on behalf of the Crown or by a public authority to a person (either directly or indirectly) in relation to that person’s taxable activity is deemed to be consideration for a taxable supply made by that person.

A “payment in the nature of a grant or subsidy” is defined as a suspensory loan or advance that has become non-repayable in terms of the conditions of the loan. The following are excluded from the definition:

(a) The payment of a monetary benefit under the Social Security Act 1964;
(b) Any other payment made for the personal use and benefit of a person or a relative (unless declared by Order in Council to be a taxable grant or subsidy);
(c) A payment declared by Order in Council not to be a taxable grant or subsidy. These include:

(i) Any payment made on behalf of the Crown for the purpose of repaying the loans (as to both principal and interest), specified in s 2(1) of the Petroleum Sector Reform Act 1988; with application from 1 January 1993.

(ii) Any suspensory loan or advance made on behalf of the Crown or by any public authority before 1 January 1993, other than any suspensory loan or advance that, at the time it was made, was explicitly stated to include the amount of any GST payable by the person to whom or for whose benefit the loan or advance was made; with application from 1 January 1993.
(iii) Any payment made by the New Zealand agency for International Development to a New Zealand organisation where, as a condition of the payment, it must be transferred outside New Zealand to an organisation that is operating overseas at that time and be used for the purpose of acquiring goods or services overseas. GST must be returned to the extent to which any portion of the grant is allocated or used for administration or building of capacity in New Zealand.

In *Chatham Islands Enterprise Trust v Commissioner of Inland Revenue* (1999) 19 NZTC 15,075 (CA), the Government established a trust to advise on and implement the handing over of responsibility for various infrastructure facilities (electricity, meat works, airport, wharf facilities, and so on) to the residents of the Chatham Islands. To finance these facilities, the Government made two payments of $4 million each to the trust. The Court of Appeal held that the payments were not subject to GST under s 8 because the trust, in performing its responsibilities, was not carrying on a taxable activity. The payments were settlements on a trust. As per Blanchard J:

“The Trust is not making a supply of anything to the settlor in exchange for, or induced by, the payments; it is the recipient of an endowment to be held upon the terms of the deed. Nor can it, consistently with well established principles, be said that the Trust is performing services for its beneficiaries in return for a consideration provided by the settlor … [T]here is no consideration passing to the Trust since the payments are not properly to be seen as an inducement. Without them, it is true, the Trust could not function; indeed it would not have even come into existence. But in law they cannot properly be characterised as inducing its functions nor can it be said that what the Trust did with the money was a response to the payment. There is an absence of reciprocity in the relationship.”

Similarly, the payments were held not to be taxable under s 5(6D)(a) because there was no taxable activity carried on by the trust to which the grants by the Crown could have related.

(12) **Local authorities** [s 5(7), (7B), (7C)]

The payment of rates to a local authority and the payment of council dues to the Chatham Islands Council are consideration for a taxable supply. Some specific types of payment are excluded. However, penalties imposed on unpaid rates and postponement fees that relate to financial costs of the local authority arising from a postponement of rates are exempt supplies if imposed on or after 1 July 2003.

The payment to a local authority of a financial contribution, in the form of money or land, under the Resource Management Act 1991, or a development contribution under the Local Government Act 2002, is deemed to be made in consideration for a supply of goods and services by the local authority. Where the contribution is in money, it is subject to GST at the standard rate of 15 per cent (12.5 per cent prior to 1 October 2010). This allows the registered person making the contribution to claim back the GST amount as an input tax deduction. Where the contribution is in the form of land, both the supply by the local authority and the supply of the land are zero-rated. This treatment avoids the difficulty of ascertaining a value for the land. The same principle applies to the transfer of land or payment of money under a territorial authority’s affordable housing policy [s 11 of the Affordable Housing: Enabling Territorial Authorities Act 2008]. Note section 5(7D) and (7E) of the GSTA, and the Affordable Housing: Enabling Territorial Authorities Act 2008, were repealed from 6 August 2010.

These provisions apply to a contribution under the Resource Management Act 1991 imposed on or after 25 November 2003. Due to the differing treatments that local authorities have afforded these contributions in the past, the provisions also apply to contributions imposed on or after 1 October 1991 where the local authority imposed tax at a rate other than zero per cent. For contributions under the Local Government Act 2002, the provisions apply to contributions imposed on or after 25 November 2003. And for transfers of land or payments of money under the Affordable Housing: Enabling Territorial Authorities Act 2008, the provisions apply to transfers or payments made on or after 18 September 2008. **Note:** The provisions relating to the Affordable Housing: Enabling Territorial Authorities Act 2008, and that Act itself, were repealed from 6 August 2010.
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(13) **Gambling** [ss 5(8)-(11C)]

The following are deemed to be payments for the supply of services:

(a) Money placed as a race bet, a totalisator bet, an equaliser bet, a fixed-odds race bet, or a sports bet conducted by or on behalf of the New Zealand Racing Board. The rules for determining the value of the supply are set out in s 10(12).

(b) Money paid to participate in gambling, a sales promotion scheme, bookmaking, a New Zealand lottery, a prize competition, or an instant game [see s 5(11)(a) of the GSTA and s 4(1) of the Gambling Act 2003 for definitions of these terms]. The value of the supply is the amount of money paid to participate in the game less the amount of money paid in prizes [s 10(14)].

(c) Money paid to a casino to purchase a chip or otherwise participate in gambling, or paid as commission for participating in gambling played or conducted in a casino venue. The value of the supply is the amount of money paid to buy chips or otherwise participate in the gambling, or paid as commission to participate in the gambling, less the amount of money paid in winnings or for redemption of chips by the casino [s 10(15A)].

Where a person pays money to participate in gambling (including a New Zealand lottery), the money paid is payment for services supplied by the person, society, licensed promoter or organiser that conducts the gambling under the Gambling Act 2003 [s 5(10)]. The time of supply of the service to participate in the gambling is deemed to be the time at which the first drawing or determination of a result commences [s 9(2)(e)]. The consideration in money for the supply is the portion of the amount that a person pays to participate in the gambling that represents the total proceeds (after deducting the amount of all prizes paid and payable in money) [s 10(14)].

If a lottery is conducted by any person, society, or corporate society that is registered (or required to be registered) for GST, output tax is payable on the amount of money paid to participate in the lottery less the amount of all prizes paid or payable in money, and input tax credits can be claimed for expenses (ie purchases of non-cash prizes, promoter fees, printing tickets, etc). If a lottery is promoted by a licensed promoter who is registered (or required to be registered) for GST, output tax is payable on any fees received, and input tax credits can be claimed for expenses connected with the promotion [see Public Ruling BR Pub 07/11, TIB vol 20:1 (February 2008) at 6].

(14) **Tokens, stamps and vouchers**

The issue or sale of a token, stamp or voucher is treated as a supply of goods and services. However, if the token, stamp or voucher is issued or sold by a registered person to another registered person (who subsequently issues or sells the token, stamp or voucher), and the first-mentioned registered person is not the person who will supply the goods and services on redemption of the token, stamp or voucher, then there is no supply of goods and services.

The redemption of the token, stamp or voucher is not treated as a supply of goods and services, unless:

(a) it is not practical for the issuer or seller of the token, stamp or voucher to treat the issue or sale of those items as a supply of goods and services (for example the issuer or seller is a member of a food franchise, a branch department store, or a fashion retailer); and

(b) the issuer or seller is, or could be, or may be, a different person from the supplier of the goods and services on redemption of the token, stamp or voucher; and

(c) both parties agree that a supply will occur on the redemption of the token, stamp or voucher.

The provision above does not apply to:

(a) the extent to which the consideration received for the token, stamp or voucher is more than the face value of any of those items. The excess must be accounted for at the time of issue or sale of those items.

(b) an adhesive label, or a mark or design that is affixed to, or that appears on stationery, indicating prepayment of the fee chargeable for the carriage of a letter, parcel or other article, without
distinguishing the letter, parcel or article from other similar items carried by the same person. Such label, mark or design must be accounted for at the time at which they are issued or sold.

(c) a token, stamp or voucher that gives the recipient the right to receive services in New Zealand from a non-resident. Such token, stamp or voucher must be accounted for at the time at which they are issued or sold.

[See further discussions in 580.67]

(15) **Sale of a going concern [s 5(12)]**

The disposition of a taxable activity as a going concern is deemed to be a taxable supply. However, such a supply is zero-rated by s 11(1)(c), provided that the buyer and the seller agree to this in writing and both parties are registered for GST [see 580.37].

(16) **Indemnity payment [s 5(13)]**

An indemnity payment received by a registered person under a contract of insurance for a loss incurred in the course of that person’s taxable activity is deemed to be consideration for a taxable supply. The supply is deemed to take place on the day on which the payment is made. The following are not taxable supplies:

(a) An indemnity payment received under a contract of insurance which is not liable for GST, and

(b) A payment to indemnify for the loss of earnings.

An indemnity payment requires an output adjustment to be made in the GST return covering the period in which the payment is received [see 580.126].

(17) **Refund of excise duty [s 5(13A)]**

A refund of excise duty paid to a registered person under s 101 of the Transit New Zealand Act 1989 is a taxable supply to the extent the excise duty was incurred for the principal purpose of making taxable supplies. The refunds relate to excise duty paid on motor spirits, CNG and LPG used as fuel for exempted vehicles, licensed vehicles and in other specified circumstances, for example, when fuel is used in commercial vessels.

(18) **Subrogation payment [s 5(13B)]**

An amount recovered by an insurer under a contract of insurance, as a result of the exercise of rights acquired by subrogation, is deemed to be consideration received for a supply of services provided that an input tax deduction has previously been allowed in relation to that amount. This does not apply to aggravated or exemplary damages received by the insurer. The time of supply is the day the insurer receives the recovery amount.

(19) **Supply partly zero-rated [s 5(14)]**

If a supply is partly zero-rated and partly charged with GST at the standard rate, each part is deemed to be a separate supply. The CIR’s interpretation of s 5(14) is discussed in interpretation statement IS 08/01 GST – Role of Section 5(14) of the Goods and Services Tax Act 1985 in Regard to the Zero-Rating of Part of a Supply [see TIB vol 20:5 (June 2008) at 8]. The CIR has concluded that s 5(14) does not of itself create standard-rated and zero-rated supplies. It is necessary to first determine that there is a “supply” that is charged with GST at the standard rate under s 8. The next step is to determine whether there is an applicable provision in ss 11, 11A, 11AB, or 11B that requires part of a supply to be charged with GST at the rate of zero per cent. An example of where apportionment is mandated by the GSTA is s 11A(1)(b), which states that a supply of services that is chargeable with tax under s 8 must be charged at the rate of zero per cent where “the services are the transport of passengers from a place in New Zealand to another place in New Zealand to the extent that the transport is by aircraft, as defined in s 2 of the Civil Aviation Act 1990, and is international carriage for the purposes of that Act”.

Interpretation statement IS 08/01 considers only the interpretation of s 5(14). It does not consider the principles of apportionment under case law, which are used to determine whether a package of goods and/or services is a single supply or, alternatively, consists of two or more supplies for the purposes of the GSTA. Where there are two or more supplies, the GST treatment of each must be separately considered. Relevant case law includes Auckland Institute of Studies Ltd v Commissioner of Inland Revenue (2002)
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20 NZTC 17,685 (HC) [see 580.43] and Commissioner of Inland Revenue v Smiths City Group Ltd (1992) 14 NZTC 9,140 (HC), which concerned whether the sale of a piece of vacant land was part of the supply of a business as a going concern. The High Court found that it was not sufficiently part of the business operations to be zero-rated as part of a going concern and should therefore be subject to GST at the standard rate.

(20) Dwelling included in a supply after 11 August 1995 [ss 5(15)-(19)]

If a dwelling is included in a supply (for example a farm house included in the sale of a farm), then the supply of the dwelling is deemed to be a separate supply from any other real property included in the overall supply [see 580.16].

580.14 Sale of goods in satisfaction of debt [ss 5(2), 17]

When goods securing a debt are sold by a creditor in satisfaction of the debt owing by the debtor, the goods are deemed to be supplied by the debtor in the course of a taxable activity. This means that the debtor is charged with GST on the proceeds of the sale of those goods. The creditor is responsible for filing a special return and paying the GST charged on the sale. However, such a sale is not treated as a taxable supply if:

(a) The debtor provides the creditor with a written statement to the effect that if the debtor had sold the goods it would not have been a taxable supply. The reasons why the supply would not be taxable must also be stated; or

(b) The creditor is unable to obtain such a statement, but is able to determine from available information that the supply would not have been taxable if the goods had been sold by the debtor.

In an interpretation statement, the CIR clarified the GST treatment of repossessed motor vehicles [see TIB vol 9:9 (September 1997) at 18-19]. The type of transaction contemplated is one where a GST-registered motor vehicle dealer sells a motor vehicle to a customer, the customer finances the purchase by a hire purchase agreement with a finance company, and the motor vehicle dealer is required to guarantee that the customer will meet all their payments. If the customer defaults on hire purchase payments, the motor vehicle dealer is required to pay the outstanding amount to the finance company. The dealer is then entitled to repossess the motor vehicle to recover its debt. The correct GST treatment of these transactions is as follows:

(a) On first purchasing the vehicle, the dealer is able to claim an input tax deduction.

(b) On sale of the vehicle to the customer, the dealer returns output tax when the hire purchase agreement is signed.

(c) When the customer defaults, the payment of the outstanding amount by the dealer to the finance company is an exempt supply (financial service) and no input tax deduction can be claimed on it.

(d) The sale of the repossessed vehicle by the dealer is covered by s 5(2). The sale is subject to GST if the customer was GST-registered and the sale would have taken place as part of a taxable activity. If the customer was not GST-registered, the dealer would not charge GST on the sale of the vehicle.

The statement applies not only to motor vehicles, but also in any similar situation in which goods are purchased by hire purchase.

TRA Case Y2 (2007) 23 NZTC 13,017 confirms that where goods are sold by a debtor, or land is sold by way of a mortgagee sale, no input tax deductions are able to be claimed by the debtor or mortgagee. The sale is deemed to be a supply made in the course or furtherance of the mortgagor’s taxable activity. Section 5(2) does not deem the mortgagee or debtor to be a registered person or to be carrying on a taxable activity.

580.16 Dwelling included in a supply [s 5(15)-(19)]

If a dwelling is included in a supply, the supply of the dwelling is deemed to be a separate supply from any other real property included in the overall supply, for example, if a farm house is included in the sale of a farm, the house and curtilage is treated as a separate supply from the supply of the rest of the farm land and buildings. This prevents the purchaser of the farm from claiming an input tax deduction in relation to the house [see 580.123]. If a registered person has claimed an input tax deduction in relation to a dwelling, any subsequent supply of the dwelling (including curtilage) is deemed to be a taxable supply.
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If an input tax deduction has been claimed in respect of a proportion of a dwelling, any subsequent sale of the dwelling is a taxable supply only to the extent of that proportion. For example, if an input tax deduction has been claimed in respect of 50 per cent of a dwelling, 50 per cent of the sale proceeds would be taxable if the dwelling were subsequently sold.

If a dwelling which was originally applied for the principal purpose of making taxable supplies is subsequently used for a non-taxable purpose, and consequently a deemed supply occurs under s 21(1), the sale of that dwelling is not deemed to be a taxable supply provided no input tax deduction under s 21(5) has been allowed.

From 1 April 2012, special rules apply to supplies of land [see 580.49]. These rules change the treatment of supplies that consist of, or include, land. They do not change the requirement to treat the supply of a dwelling as a separate supply.

In TIB vol 8:6 (October 1996) at 4-5, the CIR issued an interpretation statement on the apportionment of consideration between, and the valuation of, supplies of dwellings and other real property for the purposes of ss 5(15)-(19). The following are the main points of the statement:

(a) A dwelling includes that area surrounding the dwelling that is necessary for its enjoyment (the curtilage). Any apportionment of the consideration for the supply of a dwelling and other real property must reflect the true respective values of the dwelling and the surrounding land. If a dwelling is supplied along with other real property, it is necessary to identify the physical area of the dwelling, and the consideration that relates to the dwelling, and the area and consideration that relates to the other real property.

(b) The onus of proof that an apportionment is correct is on the person seeking to rely on the apportionment. To satisfy this onus, it may be necessary to support the apportionment with a valuation. In cases of doubt, or where significant amounts of consideration are involved, Inland Revenue may require a valuation from a registered valuer. The method of valuation depends on the circumstances of the case. The method adopted should reflect the true value of the property. Different circumstances may require different methods. An area apportionment may not always be appropriate. In some cases, it may be more appropriate to value residential land on farm properties by comparison with sales of residential properties in nearby rural townships. If registered persons are in doubt as to whether they need to obtain a valuation from a registered valuer, they should contact their local Inland Revenue office. Any valuation relied on needs to identify the method of valuation used and the reasons for adopting that method.

(c) When the supplier and the recipient are both GST-registered, the same apportionment, as set out in the tax invoice, will apply to both parties. Ideally, this should be negotiated between the parties and agreed at the time of supply.

(d) When a purchaser intends to use a part of the curtilage for the making of taxable supplies, or part of the other real property for the dwelling, ongoing adjustments under s 21 will be required.

Where land holds legal rights to erect a residential dwelling on a portion of the land, apportionment of cost (based on land area set aside for the residential dwelling where typography and other considerations are not relevant) is available for GST purposes. There is no requirement to value the right to erect a dwelling and add it to the value of the land set aside for that purpose [see M Lodder and B Clark “Cost Equals cost?” Chartered Accountants Journal of New Zealand vol 83:2 (March 2004) at 34].

The CIR has ruled, in public rulings BR Pub 10/10, 10/11, 10/12 and 10/13 [see TIB vol 22:10 (November 2010 ) at 3-23], that the consideration for the supply of dwellings and other real property includes local authority rates apportioned between the buyer and the seller and any rates arrears where the purchaser takes over this obligation. The GST treatment of the rates apportionment will be the same as that for the other consideration for the property. Therefore, the purchaser will be entitled to claim the input tax in the rates apportionment only if input tax can be claimed for the other consideration.

580.20 Exempt supplies [ss 8, 14]

Supplies of goods and services which are exempt are not charged with GST. Exempt supplies are supplies of a type that would ordinarily be taxable if they were not specifically exempted. To the extent that a registered
person carries on any activity which is exempt, the registered person is not required to account for GST on any supplies made, and is unable to claim input tax deductions for supplies received.

“Exempt supplies” are defined as the supply of:

(a) Financial services;

(b) Donated goods and services by a non-profit body;

(c) Accommodation in a dwelling (but not a commercial dwelling [see 580.66]), supplied by way of hire (rent), a service occupancy agreement, or a licence to occupy;

(d) Leasehold land for rent, where the land is used principally for accommodation in a dwelling;

(e) A dwelling, or the reversionary interest in the fee simple estate of leasehold land, which has been used exclusively as rental accommodation for at least five years. In order to be exempt, the supply must be made by a registered person in the course of a taxable activity;

(f) Fine metal which is not zero-rated.

A “dwelling” is any place used predominantly as a place of residence or abode. It includes any appurtenances belonging to or enjoyed with the place, but does not include any of the following:

(a) A hospital;

(b) A hotel, motel, inn, hostel, or boardinghouse;

(c) A serviced apartment for which paid services in addition to the supply of accommodation are provided to a resident, and in relation to which a resident does not have quiet enjoyment, as that term is used in s 38 of the Residential Tenancies Act 1986;

(d) A convalescent home, nursing home, or hospice;

(e) A rest home or retirement village, except to the extent that, in relation to a relevant place, it is, or can reasonably be foreseen to be, occupied as a person’s principal place of residence for independent living;

(f) A camping ground.

This definition applies from 1 April 2011.

580.22 Financial services [ss 3, 14(a)]

The supply of financial services is exempt from GST. Also exempt are any other goods and services which are reasonably incidental and necessary to the supply of financial services. The following are not exempt:

(a) Financial services which are zero-rated (for example financial services provided outside New Zealand or certain business to business financial services);

(b) The supply, under an equity security or participatory security, of a right to the supply of goods and services at other than market value; and

(c) A part of a supply of financial services which is not, as between the supplier and the recipient, a supply of financial services.

“Financial services” includes:

(a) The exchange of currency by exchanging bank notes or coins, crediting or debiting accounts, or by any other means. “Currency” means any banknote or other currency of any country except when used as a collector’s item, investment article, item of numismatic interest, or for any purpose other than as a medium of exchange;

(b) The issue, payment, collection, or transfer of a cheque or letter of credit. “Cheque” means a cheque as defined in the Bills of Exchange Act 1908, an instrument specified in s 5(2) of the Cheques Act 1960, a postal note, money order, traveller’s cheque, or any order or authorisation to a financial institution to credit or debit any account;
(c) The issue, allotment, drawing, acceptance, endorsement, or transfer of a debt security. “Debt security” means any interest in or right to be paid money owing or to become owing by any person. A cheque is not a debt security;

(d) The issue, allotment, or transfer of an equity security or a participatory security. “Equity security” means any interest in or right to share in the capital of a corporate body. “Participatory security” means any interest or right to participate in any capital, assets, earnings, or other property where that interest or right forms part of a contributory scheme. It includes an interest in a unit trust but not an equity security, a debt security, money or a cheque. “Contributory scheme” is defined in s 2 of the Securities Act 1978;

(e) Underwriting or sub-underwriting the issue of an equity security, debt security or participatory security;

(f) The provision of credit under a credit contract. “Credit contract” is defined in s 3 of the Credit Contracts Act 1981 (immediately before its repeal); however, a taxpayer may choose to use the definition contained in s 7 of the Credit Contracts and Consumer Finance Act 2003. This choice has been backdated to 1 April 2005 to accommodate finance leases that do not result in a deferral of debt;

(g) The renewal or variation of a debt security, equity security, participatory security, or credit contract;

(h) The provision, taking, variation or release of a guarantee, indemnity, security or bond for a cheque, credit contract, equity security, debt security or participatory security, or for any of the activities (b) to (g) above;

(i) The provision or transfer of a life insurance contract or the reinsurance of such a contract. “Life insurance contract” means “a contract lawfully entered into to the extent that it places a sum or sums at risk upon the contingency of the termination or continuance of human life, marriage, civil union or de facto relationship, or the birth of a child, but not to the extent that it provides for entitlements under sch 1, Part 5 of the Accident Insurance Act 1998 (which relates to entitlements arising from fatal injuries)”. The term was extended to include civil unions with effect from 26 April 2005, and de facto relationships with effect from 1 April 2007;

(j) The provision or transfer of an interest in a superannuation scheme, or the management of a superannuation scheme. “Superannuation scheme” is defined in the Superannuation Schemes Act 1989;

(k) The provision or assignment of a futures contract through a futures exchange or at arm’s length if:
   (i) The contract does not provide for the delivery of a commodity; or
   (ii) The contract provides for the delivery of a commodity and the supply of the commodity is an exempt supply; or
   (iii) The contract provides for the delivery of money;

(l) The provision of a financial option;

(m) The payment or collection of interest, principal, dividend or other amount in respect of a debt security, equity security, participatory security, credit contract, contract of life insurance, superannuation scheme or futures contract;

(n) Agreeing to do, or arranging, any of the activities listed in (a) to (m) above;

(o) The investment in equity securities or participatory securities issued by another entity where:
   (i) The investment represents a 10 per cent or greater interest in the equity securities or participatory securities issued by that other entity; and
   (ii) The investment terms allow the investor, or a person acting on the investor’s behalf, to influence the management of the business of the entity;

(p) The evaluation by an investor of an investment, referred to in activity (o) above, and the planning or action by the investor to influence the management of the entity in the best interests of the investment.
The terms “debt security”, “equity security”, and “participatory security” do not include insurance contracts, shares in a flat-owning or office-owning companies, or interests in superannuation schemes. Prior to 3 April 2006, these terms also did not include estates or interests in land (except as mortgagee or charge-holder). Cheque clearance fees charged by banks to their customers are charges for financial services, and consequently exempt from GST. Where a retailer (eg a supermarket), charges fees to customers making payments by cheque, the fee is not a charge for financial services and GST must be accounted for on these fees [see PIB 148 (May 1986)]. The retailer’s charge does not come within the definition of financial services in s 3 and so it does not qualify for the exemption in s 14 [see TIB vol 3:5 (March 1992) at 9].

In the insurance industry, for policies which cover life and fire and general insurance, GST is not charged on the life insurance as it is an exempt supply but it is charged on that part of the premium that relates to other non-exempt insurance [see TIB vol 3:5 (March 1992) at 3]. However, from 1 April 1999, any minimal life insurance component contained in accident insurance contracts provided under sch 1, Part A of the Accident Insurance Act 1998 is treated as a taxable supply. This change is intended to reduce compliance costs.

A share is an equity security and, therefore, trading in shares cannot constitute a taxable activity for GST purposes, as it is a financial service which is an exempt supply [see TIB vol 6:9 (February 1995) at 23]. Subscription to a redeemable preference share which secured for the owner the right to use golf club facilities was found to be an exempt supply: Commissioner of Inland Revenue v Gulf Harbour Development Ltd [2005] 2 NZLR 162, (2004) 21 NZTC 18,915 (CA). This decision is overturned by legislative amendment, effective from 3 April 2006. The amendment covers the supply of rights to goods and services under an equity security or participatory security. If part of the supply of an equity security or participatory security involves an “associated supply”, the “associated supply” is treated as a separate supply [s 5(14B)]. An “associated supply” is defined in s 2 as including a supply where the supplier and recipient are associated persons and/or a supply of a right, under an equity security or participatory security to the supply of goods and services at other than market value.

An “associated supply” is excluded from the definition of “financial services”. There are two exclusions from the definition of “associated supply”. These are where the rights are to receive an exempt supply (such as interest or dividends), or where the supply relates to the control of the issuer of the security (such as voting rights).

The market value rules do not apply where the consideration equals or exceeds open market value, nor do they apply where, from the time of supply, the recipient applies the goods and services for the purposes of making taxable supplies. Where an associated supply arises because of a discount which applies to security holders, the treatment will depend on whether the discounted price is market value such as, for example, where the same discount is available to members of the public.

The time of supply for an “associated supply” is the earliest of the time at which:

(a) An invoice is issued;
(b) Any payment is made in respect of the supply;
(c) The goods are removed by the recipient or made available to the recipient; or
(d) The services are performed.

The sale of cards entitling the holders to purchase meals at nominated restaurants at a discount does not constitute the supply of a financial service for GST purposes and is, therefore, not an exempt supply: TRA Case S54 (1996) 17 NZTC 7,354.

Section 3(4)(b) excludes the provision of debt collection services from the definition of “financial services” unless the services are provided by the creditor in relation to the debt. Therefore, the activities of debt collection agencies and bill-pay agencies are subject to GST as from 10 October 2000. Penalties and default interest (including penalties on unpaid rates and postponement fees under the Local Government (Rating) Act 2002) are treated as considerations for exempt supplies.
(1) **General accounting and record package services**

The provision of the following types of services to suppliers of financial services or their customers is not a supply of financial services:

(a) The provision of a financial clearing system as part of a settlement process;
(b) The posting of transactions to customers’ accounts;
(c) The maintenance of customers’ accounts;
(d) The provision of ancillary services such as network management, software support and development.

For example, the supply of financial clearance services by EDS to the trading banks is not the supply of a financial service and, consequently, is taxed at the standard rate of 15 per cent (12.5 per cent prior to 1 October 2010).

However, if such services are supplied directly by the supplier of financial services (ie the bank) to its customers, they are treated as financial services if they are reasonably incidental and necessary to the supply of financial services, for example, if a bank or other financial institution maintains records of customers’ accounts and charges them for this service as part of its overall banking operations, this supply would be exempt because it is incidental to the supply of financial services.

The meaning of financial services [s 3] was amended in December 1989 to exclude the supply of general accounting and record package services provided to suppliers of financial services. The reason for the amendment was to reverse the effect of the Court of Appeal decision in *Databank Systems Ltd v Commissioner of Inland Revenue* [1989] 1 NZLR 422, (1989) 11 NZTC 6,093 (CA), that the supply of financial clearing and record-keeping services by Databank to trading banks was a financial service and, therefore, exempt from GST.

(2) **Financial planning fees**

In an interpretation statement [see TIB vol 13:7 (July 2001) at 37-50], *Financial planning fees — GST treatment*, the CIR clarified the GST treatment of services provided in relation to financial planning fees charged by financial advisers to plan, implement, and monitor an investment portfolio for their investor clients. The interpretation statement replaces public ruling BR Pub 95/11, which ceased to apply from 31 March 1999.

The CIR’s views can be summarised as follows:

(a) *Initial planning fees* are subject to GST. They do not constitute financial services under any of paragraphs (a) to (ka) of s 3(1), nor do they, as undertaken by advisers, generally constitute the “agreeing to do or arranging” of any of the activities listed in paragraphs (a) to (ka) in terms of paragraph (l). The initial planning services do involve advisers in “advising” the investor on an investment programme, and therefore come within the specific exclusion from the definition of a financial service in s 3(1)(l).

(b) *Implementation fees* will be financial services under s 3(1)(c), (d), and/or (l), and as such they are exempt supplies under s 14(1)(a).

(c) *Administration fees* provided in relation to maintaining records constitute exempt supplies either:

(i) By virtue of being financial services coming within one of the paragraphs in s 3(1); or
(ii) By being reasonably incidental and necessary to the supply of those financial services in terms of s 14(1)(a).

(d) *Monitoring fees* will be regarded as not constituting a financial service in terms of s 3(1), or an exempt supply in terms of s 14(1)(a), and are therefore subject to GST.

(e) *Evaluation fees* are subject to GST to the extent that the services involve agreeing to do, or arranging, any of the activities specified in s 3(1)(a) to (ka), the services falling squarely within the “advising” exclusion in s 3(1)(l).
(f) Replanning fees do not come within any of paragraphs (a) to (ka) of the definition of “financial services” in s 3(1). However, to the extent that these services involve agreeing to do, or arranging, any of the activities specified in s 3(1)(a) to (ka), they fall squarely within the “advising” exclusion in s 3(1)(l). Replanning fees are therefore subject to GST.

(g) Switching fees are treated in the same way as implementation fees because s 3(1) applies to switching fees in the same way as it applies to implementation fees.

580.23 Donated goods and services [s 14(b)]

When a non-profit body sells goods and services that have been donated to it, that supply is exempt from GST (eg the sale of clothing and furniture by Salvation Army stores where the clothing and furniture was donated). In TRA Case X19 (2006) 22 NZTC 12,255, the TRA held that the sale of a car, that was won in a lottery by a non-profit sporting club, was an exempt supply.

The donated goods and services must have been gifted to the non-profit body and they must have been intended to be used for the purposes of that non-profit body. The sale by a non-profit body of unclaimed lost property left on its premises is not exempt as it has not been donated [see TIB vol 6:9 (February 1995) at 23].

“Non-profit body” means any society, association, or organisation which is not carried on to provide profits or gains to any proprietor, member, or shareholder, and the rules or constitution of the body prohibit the making of any distribution of money or property to any proprietor, member, or shareholder. The definition includes both incorporated and unincorporated bodies.

580.24 Residential accommodation [ss 14(c), (ca)]

The supply of accommodation in any dwelling by way of hire, a service occupancy agreement, or a licence to occupy is exempt from GST.

A “dwelling” is any place used predominantly as a place of residence or abode. It includes any appurtenances belonging to or enjoyed with the place, but does not include any of the following:

(a) A hospital;
(b) A hotel, motel, inn, hostel, or boardinghouse;
(c) A serviced apartment for which paid services in addition to the supply of accommodation are provided to a resident, and in relation to which a resident does not have quiet enjoyment, as that term is used in s 38 of the Residential Tenancies Act 1986;
(d) A convalescent home, nursing home, or hospice;
(e) A rest home or retirement village, except to the extent that, in relation to a relevant place, it is, or can reasonably be foreseen to be, occupied as a person’s principal place of residence for independent living;
(f) A camping ground. [s 2].

This definition applies from 1 April 2011.

TIB vol 23:1 (Feb 2011) at 44 states:

“For accommodation to be in a “dwelling” the relevant premises must be occupied by the recipient as their principal place of residence or it must be reasonably foreseeable that this will be the case.”

As it is the supplier of the accommodation that needs to determine whether the premises will be occupied as the tenants as their principal place of residence, landlords may wish to obtain a written statement from the tenant as to whether or not this will be the case. The following examples illustrates the problem:

Example 1

John and his family live in rented accommodation in Auckland. John is seconded to Wellington for a year and rents an apartment which he lives in from Monday morning to Friday evening, returning to his family for the weekend. Where is John’s principal place of residence? Can he have more than one? Case law (though not in relation to the GST Act, suggests that this is possible.
Example 2
Mary lives in a rented house in Hamilton. The landlord decides to renovate the house over summer. The landlord pays for storage of Mary’s furniture and belongings and Mary rents a beach cottage for the four weeks of the renovation process which coincides with her annual leave. Is the beach cottage her principal place of residence for that four week period? It probably is, but how will the owner of the beach cottage know that?

Example 3
Tekno Ltd seconds one of its Christchurch employees to Auckland for six months. During this period, the company rents a house for the employee to live in. As the recipient of the supply is the company and the company will not be occupying the house as its principal place of residence, is the accommodation in a dwelling and, therefore, is it able to be treated as a GST-exempt supply?

These issues have been pointed out to Inland Revenue. They have undertaken to provide some guidance in a future TIB. The exemption applies only to residential accommodation, not to commercial accommodation (offices, business premises, workshops, etc). The exemption also does not apply to “commercial dwellings”, which are defined in s 2 as:

(i) A hotel, motel, homestay, farmstay, bed and breakfast establishment, inn, hostel, or boarding-house;
(ii) A serviced apartment managed or operated by a third party for which services in addition to the supply of accommodation are provided and in relation to which a resident does not have quiet enjoyment, as that term is used in section 38 of the Residential Tenancies Act 1986;
(iii) A convalescent home, nursing home, rest home, or hospice;
(iv) A camping ground;
(v) Premises of a similar kind to those referred to in subparagraphs (i) to (iv).

The following are not commercial dwellings and, therefore, are exempt supplies:

(i) A hospital except to the extent to which the hospital is a residential establishment;
(ii) A dwelling situated in a retirement village or rest home if the consideration paid or payable for the supply of accommodation in the dwelling is for the right to occupy the dwelling.

This definition applies from 1 April 2011.

Special provisions apply to the valuation of accommodation in commercial dwellings [see 580.66]. The term “hire” includes a letting on any terms, including a lease [s 2]. It therefore includes the renting or leasing of residential accommodation.

A “service occupancy agreement” means a licence under which a person occupies a dwelling for no consideration [s 2].

A “licence to occupy” means the right to exclusive personal occupancy [s 2].

In Norfolk Apartments Ltd v Commissioner of Inland Revenue (1995) 17 NZTC 12,212 (CA), the Court of Appeal upheld the High Court’s decision that the CIR had acted correctly in disallowing claims for input tax deductions or refunds of GST associated with the purchase of land and the costs of construction of a retirement village, which was an exempt activity. The taxpayer’s argument that it was making both exempt and taxable supplies was not upheld.

The supply of leasehold land by way of rental is also exempt from GST to the extent the land is used for the principal purpose of accommodation in a dwelling erected on that land. Exemption does not apply to the grant or sale of the lease itself [s 14(ca)]. The CIR has released a binding ruling on the question of when a supply of leasehold land is exempt from GST [see TIB vol 20:7 (August 2008) at 13]. Public ruling BR Pub 08/01 (applies for an indefinite period from 1 February 2006) can be summarised as follows:

(a) Where the leasehold land that is the subject of the supply is only used for the principal purpose of accommodation in a dwelling erected on that land, the supply is exempt from GST;
(b) Where the leasehold land that is the subject of the supply is not used, to any degree, for the principal purpose of accommodation in a dwelling erected on that land, the supply is not exempt from GST;
Where the leasehold land that is the subject of the supply is used for the principal purpose of accommodation in a dwelling erected on that land and for another use, the supply is exempt from GST to the extent that the leasehold land is used for the principal purpose of accommodation in a dwelling erected on that land, irrespective of whether the predominant use of the land is for the principal purpose of accommodation in a dwelling erected on that land;

Where the leasehold land that is the subject of the supply is used for the principal purpose of accommodation in a dwelling erected on that land and for another use, the apportionment of the value of the supply between the exempt and non-exempt uses must be made on the basis of allocating that proportion of the supply that is fairly attributable to the exempt supply.

Where a lease is entered into for leasehold land, and that land is to be used for the principal purpose of accommodation in a dwelling erected on that land, the supply of that leasehold land pursuant to the lease (or the relevant portion of the lease) is not exempt until the dwelling has been erected.

In *Wairakei Court Ltd v Commissioner of Inland Revenue* (1999) 19 NZTC 15,202 (HC), a company had extended an existing rest home, constructing studio units (described as bed sits) and six stand-alone villas. The company created separate licences to occupy the studio units and villas. The issue was whether the supply of these rest home facilities was a taxable or an exempt supply. The High Court reviewed a number of previous decisions and held that the principal purpose test set out in the definition of “input tax” [s 3A] requires making an overall evaluation of all relevant purposes at the time the goods and services were acquired. Applying this test, the Court found that the studio units came within the definition of “commercial dwelling” because the licences to occupy were merely a legal mechanism to deliver care to the elderly. However, the licences to occupy the villas did not carry the same entitlement of care delivery. As a result, the villa accommodation was held to be an exempt supply as the villas were not commercial dwellings.

Further information can be found in the CIR’s Interpretation Statement IS 10/07 – 10/08 which is available on Inland Revenue’s website www.ird.govt.nz

**580.25 Sale of residential rental properties [s 14(d)]**

The supply of residential accommodation by way of lease is always an exempt supply [see 580.24]. As the provision of exempt supplies is not a taxable activity, the sale of a property that has been used for residential rental will generally also be an exempt supply.

However, where the sale of residential dwellings occurs frequently enough to make it continuous and regular, and the sales are not due to the cessation or winding down of the rental activity, a taxable activity of supplying dwellings by way of sale may exist. In these cases, if a registered person has used a dwelling exclusively for residential rental accommodation (of the types outlined in 580.24) for a period of at least five years, the sale of that property is exempt from GST. This applies also to a reversionary interest in the fee simple estate of any leasehold land.

The CIR has issued interpretation statement IS07/01 on the application of GST to the sale of long-term residential properties by persons who are also carrying on a taxable activity of selling residential rental properties [see TIB vol 19:5 (June 2007) at 16-21]. Interpretation statement IS07/01 provides that all of the following criteria must be satisfied in order for the supply to be an exempt supply under s 14(d):

(a) The supply must be by sale.

(b) The supply must be by a registered person in the course or furtherance of any taxable activity. A person will usually have a taxable activity of selling residential properties if that person sells properties continuously or regularly: *TRA Case S36* (1995) 17 NZTC 7,237.

(c) The property must have been used for residential, rather than commercial, rental purposes.

(d) The property must have been used exclusively for rental purposes. If the property has been used partly for rental purposes and partly for other purposes, the sale will not be exempt. For example, a property developer who rents out property for residential purposes while trying to sell the property does not meet this test. A property developer can only take advantage of the exemption if the property has been used exclusively for rental purposes. It cannot apply when the property has been used for two
purposes, one a taxable supply (property development) and one an exempt supply (rental accommodation), as the property has not been used exclusively for the exempt purpose.

(e) The vendor must have rented out the property for at least five years. It is not sufficient that the property has been rented out for a minimum of five years by different owners. It is not necessary for the same tenant to have occupied the property for the entire period. Where the property is vacant while a new tenant is sought, the vacancy period is regarded as being a period during which the property is used for residential rental purposes.

Example:
Bill, who is not registered, sold a house to PD Ltd, a property developer. Bill had rented out the house for 15 years prior to the sale. This sale is not a taxable supply as it was not a sale in the course or furtherance of a taxable activity. PD Ltd claimed a “secondhand goods” input tax deduction as the property was acquired for the principal purpose of making taxable supplies. PD Ltd continued to rent out the property while developing it. Four years after acquiring the house, PD Ltd sold the house in the course of its taxable activity of property development. This sale is not an exempt supply for two reasons:

(a) During the time that the property was rented, PD Ltd was trying to sell it as part of the property development. Therefore, it was not used exclusively for rental purposes.
(b) PD Ltd did not rent out the house for five years.

PD Ltd must account for output tax on the sale of the house.

580.26 Fine metal [s 14(e)]

The supply of fine metal is exempt from GST, unless it is a supply of new fine metal which is zero-rated under s 11(1) [see 580.38].

“Fine metal” means gold, silver or platinum (or any other substance declared by the Governor-General, by Order in Council, to be fine metal) which has a fineness (purity) of not less than the following percentage:

<table>
<thead>
<tr>
<th>Metal</th>
<th>Fineness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gold</td>
<td>99.5%</td>
</tr>
<tr>
<td>Silver</td>
<td>99.9%</td>
</tr>
<tr>
<td>Platinum</td>
<td>99.0%</td>
</tr>
</tbody>
</table>

580.30 Zero-rated supplies [s 11]

Zero-rated supplies are supplies which are taxable but which have GST charged on them at the rate of zero per cent. They differ from exempt supplies in that persons making zero-rated supplies can register for GST and claim back the GST on expenses incurred in making zero-rated supplies.

The following supplies are zero-rated:

Goods [s 11]:
(a) Exported goods;
(b) Duty-free goods;
(c) Goods destined for export but which died or were destroyed or ceased to exist;
(d) Boats and aircraft exported under their own power;
(e) Goods not situated in New Zealand at the time of supply and either the goods are not situated in New Zealand at the time of delivery to the recipient and/or GST is paid by the recipient on the importation of the goods into New Zealand;
(f) Goods and services used in relation to temporary imports;
(g) Goods for consumption outside New Zealand on foreign going aircraft, fishing vessels and ships;
(h) Taxable activities sold as going concerns to registered persons;
(i) New fine metal;
(j) Goods supplied in consideration for the transfer or surrender of certain emissions units;
(k) Land supplied to another registered person who intends to use it in the carrying on of a taxable activity [see 580.49].

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**Services** [s 11A]:

(a) International transportation of passengers and goods, and associated services;
(b) Services in connection with land situated outside New Zealand;
(c) Services in connection with moveable personal property situated outside New Zealand;
(d) Services supplied to overseas postal organisations for the delivery in New Zealand of postal articles mailed outside New Zealand;
(e) Services physically performed outside New Zealand;
(f) Services supplied to non-residents who are outside New Zealand at the time of supply (other than services directly in connection with land or moveable personal property situated in New Zealand, and not being the acceptance of an obligation to refrain from carrying on a taxable activity to the extent to which that activity would have occurred in New Zealand);
(g) The supply of information to a person not resident in New Zealand and who is outside New Zealand, where the services are in relation to moveable personal property situated in New Zealand;
(h) Services provided in relation to intellectual property rights for use outside New Zealand;
(i) Services provided in relation to intellectual property rights to non-residents who are outside New Zealand at the time of supply;
(j) Services provided in relation to goods under warranty to the extent to which the services are provided under the warranty for a consideration given by a non-resident warrantor who is not a registered person and who is outside New Zealand at the time at which the services are performed;
(k) Certain business-to-business financial services;
(l) The acceptance of an obligation to refrain from carrying on a taxable activity outside New Zealand;
(m) The transfer, surrender, sale or disposal of certain emissions units;
(n) The supply of services in consideration for the transfer or surrender of certain emissions units.

**Territorial authorities** [s 11B]:

(a) Proceeds from the Local Authorities Petroleum Tax paid to a territorial authority under s 198 of the Local Government Act 1974.

Each of these types of zero-rated supply is explained in more detail in subsequent paragraphs.

**580.31 Business to business financial services** [ss 10(3B), 11A, 20F]

Historically, “business to business” financial services have been exempt from GST. This treatment has resulted in over-taxation. From 1 January 2005, the supply of financial services from providers to business customers are zero-rated if the customer is GST registered and makes taxable supplies to equal or exceed 75 per cent of total supplies. The provisions also zero-rate the supply of financial services to customers who may not, themselves, meet the 75 per cent test, but are members of a wholly-owned group and the group as a whole does meet the test (eg financial services provided to the head office company in the group) [ss 11A(1)(q), 11A(1)(r)].

An additional input tax deduction is allowed for supplies of financial services from one financial services supplier to another (eg bank to bank). The amount of the deduction is determined by the ratio of taxable to exempt supplies made by the service recipient. The ratio is determined by statistics supplied by the recipient [ss 20C, 20D].

The calculation method for the deduction is contained in s 20C which provides the following formula:

\[
\frac{a \times b}{c \times d}
\]

Where:

“a” is the total amount in respect of the taxable period that the registered person—
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580.32

(i) would not be able to deduct under s 20(3) in the absence of this section; and

(ii) would be able to deduct under s 20(3), other than under s 20(3)(h), if all supplies of financial services
by the registered person were taxable supplies;

“b” is the total value of exempt supplies of financial services by the registered person to the direct supplier
in respect of the taxable period;

“c” is the total value of exempt supplies of financial services by the registered person in respect of the taxable
period;

“d” is the total value of taxable supplies by the direct supplier in respect of the taxable period, determined
under s 20D; and

“e” is the total value of supplies by the direct supplier in respect of the taxable period, determined under
s 20D.

The proposal is optional and providers of financial services who wish to take advantage of the potential
reduction in costs must elect in writing into the regime [s 20F].

The CIR will provide methods by which the financial services provider can estimate the level of taxable
supplies made by its customers. Provided that such a method is complied with, no retrospective adjustments
will be made if the estimate is found to be inaccurate.

Financial services that are provided to associated parties are required to be valued at market value for the
purposes of the zero-rating provision.

The CIR has issued guidelines for working with the new rules [see TIB vol 16:10 (November 2004) at
54-71].

580.32 Exported goods [s 11(a)-(g)]

Goods that are exported are zero-rated. Zero-rating applies to goods that have actually been exported, goods
that have been entered for export under the Customs and Excise Act 1996, and goods destined for export but
which died or were destroyed or ceased to exist. See s 11(1)(a)-(n) for the specific conditions that must be
satisfied before exported goods can be zero-rated.

A supply of goods is zero-rated only if the supplier directly exports the goods. For example, if a manufacturer
sells goods destined for export to an exporting company, and the exporting company actually exports the
goods, the supply by the exporting company is zero-rated but the supply by the manufacturer is not [see TIB
vol 6:10 (March 1995) at 18].

The one exception to this rule is where all of the following apply:

(a) The goods are supplied to a non-resident;
(b) The goods have been, or will be entered for export by the supplier as a condition of the supply;
(c) The goods are exported by the recipient;
(d) The recipient does not intend to later import the goods into New Zealand for use other than in making
taxable or exempt supplies;
(e) The lack of intention to re-import is confirmed in a document which is retained by the supplier;
(f) The goods are not used or altered by the recipient prior to export except to the extent necessary to
prepare them for export;
(g) The goods leave New Zealand at or before the time of supply; and
(h) The goods do not leave New Zealand in the possession of a passenger or crew member of an aircraft
or ship.

This exception applies from 17 May 2007 [s 11(1)(eb)].

For goods exported by mail with a value of $1,000 or more, Inland Revenue requires a customs export entry.
The export entry and a copy of an international parcels customs declaration (form C2/CP3) stamped by a
postal officer when the parcel is posted, are sufficient evidence of export. A customs export entry is not
required for exports with a value of less than $1,000. Acceptable evidence of export for goods with a value of less than $1,000 is either an international parcels customs declaration (form C2/CP3 for parcels with a value of $620 or more, or form C1 for parcels with a value of less than $620) stamped by a postal officer at the time of posting, or a till receipt for the foreign postage [see TIB vol 6:8 (January 1995) at 21].

Goods that have been entered for export must be actually exported within 28 days of supply or they are taxed at the standard rate of 15 per cent (12.5 per cent prior to 1 October 2010). Inland Revenue may extend this 28 day period if circumstances beyond the control of the exporter and the recipient have prevented export within 28 days or if, because of the nature of the supply, it is not practicable to export the goods within 28 days. Where the goods have died, been destroyed, or ceased to exist prior to export, in circumstances beyond the control of both the supplier and the recipient, the supply is to be treated as if the goods had been exported.

Zero-rating does not apply to exported goods:
(a) For which a secondhand goods input tax deduction has been claimed by either the registered person or an associated person of the registered person [see 580.145]; or
(b) That have been or will be re-imported to New Zealand by the supplier.

From 6 October 2009, there is one exception to this prohibition on zero-rating of goods, for which a secondhand goods input tax deduction has been claimed. In order for the exception to apply, the recipient of the goods must give the registered person a written undertaking that neither the recipient nor an associated person of the recipient will cause the goods to be re-imported into New Zealand in substantially the same condition. An obvious example of where this provision may apply is the export of scrap metal which a scrap metal dealer has acquired from various members of the public. The fact that the metal may eventually be re-imported into New Zealand as a new product (eg gate latches), would not breach the conditions for the exemption. In the event that the goods are re-imported into New Zealand and are reacquired by the registered person who claimed the zero-rated treatment, the person is deemed to have supplied the goods at that time and in the course of carrying on a taxable activity. Therefore, output tax must be accounted for. The deemed supply does not occur if GST is paid at the border on re-importation of those goods.

(1) **Bloodstock**

For zero-rating to apply, it must be the supplier who enters the animal for export under the Customs and Excise Act 1996. The export must be in the course of, or as a condition of, the supply contract. The animal must be exported within 28 days of the time of supply. If the animal is exported by the purchaser, then zero-rating does not apply.

Where bloodstock is sold and destined for export, but cannot be exported within 28 days of the time of supply due to the nature of the contract, the supplier may apply for an extension of up to 24 months in which to export the animal. To qualify for the extension, the animal must not be used for commercial activities (for example for breeding, racing or entry into show in New Zealand). A request for an extension of time beyond 28 days must be made in writing and be accompanied by a copy of the contract of supply. If the animal is still in New Zealand at the end of the 24-month period, then GST becomes payable whether or not the animal is later exported [see TIB vol 19:3 (April 2007) at 91].

(2) **Animal trophies**

Animal trophies supplied to overseas (non-resident) tourists by the tourist, hunting, and safari industry are zero-rated in some circumstances. Animal trophies include mounted trophies, salted skins, and horns of animals, including fish and birds. The three main types of supplies and their GST treatment are as follows:

(a) **Taxidermy and mounting services provided by a taxidermist:** These services are chargeable with GST at the standard rate of 15 per cent (12.5 per cent prior to 1 October 2010). They generally are not zero-rated because they are performed in connection with movable personal property situated in New Zealand at the time the services are performed [s 11(2)(e)(ii)]. However, where the supply of the service is consistent with the requirements of s 11A(1)(m), and the goods are exported under circumstances where ss 11(1)(d), 11(1)(e), and 11(1)(eb) are satisfied or entered for export, zero-rating may apply [see TIB vol 19:7 (August 2007) at 19-20].
(b) Packaging and shipping of trophies: This is zero-rated under s 11(2)(ac) [see 580.39] because it involves the arranging of the transport of goods from a place in New Zealand to a place outside New Zealand.

(c) Trophy fees: These fees are zero-rated under s 11(1)(ac), provided the person charging the trophy fee is the same person who enters the goods for export. In addition, the export must take place within 28 days of supply, or such extended period as the CIR may allow under s 11(1C)(b). An extension of time is permitted if it is not practicable to export the goods within 28 days due to the nature of the supply. It is the CIR’s practice to grant extensions of up to 183 days. A request for an extension must be made in writing to the local Inland Revenue office and be accompanied by a copy of the supply contract.

(3) Goods sold to tourists

Six categories of exported goods sold in New Zealand to tourists and other persons departing from New Zealand can be zero-rated:

(a) Goods sold to departing travellers by a shop operating in the Customs-controlled area of an airport, unless the goods are normally intended to be used within that area;

(b) Goods sold to a customer before the customer leaves New Zealand, where the supplier delivers the goods to the Customs-controlled area of the airport, provided the customer does not take possession of the goods at any time outside the Customs-controlled area;

(c) Goods sold to persons departing by sea, where the purchaser does not have access to the goods at any time before the ship has left the final New Zealand port;

(d) Goods sold by a supplier licensed as an export warehouse, where the supplier has been licensed by the Comptroller of Customs to operate a sealed bag system;

(e) Goods posted or couriered overseas by the supplier; and

(f) Goods sold by shops licensed as export warehouses which operate within the Customs-controlled area of an international airport, where the goods are sold to departing travellers who uplift the goods on their return to New Zealand.

In each case the supplier must keep sufficient information to provide evidence for the zero-rating claim [see TIB vol 6:7 (December 1994) at 13-15].

When goods with a value of less than $1,000 are sold to customers from visiting cruise ships, there is no requirement for them to be entered for export. The goods may be zero-rated if the supplier follows these procedures:

(a) Obtain a document signed by the ship’s purser that contains a clause to the effect that the purchaser will not have access to the goods while they are in New Zealand. The goods may only be made available to the purchaser after the vessel has left its final New Zealand port of call.

(b) Keep records that identify the purchaser’s name and address, and the vessel’s name and departure date, together with a copy of the document signed by the purser [see TIB vol 7:1 (July 1995) at 22].

580.33 Duty-free goods [s 11(1)(h)]

Goods are zero-rated in the following situations:

(a) Goods purchased from a duty-free shop in a Customs-controlled area by an inbound air traveller, or an outbound air traveller who collects the goods on return to New Zealand;

(b) Where a retailer sells goods to a tourist and arranges to send the items overseas to the buyer;

(c) When a retailer arranges to send the items to an overseas customer;

(d) Goods purchased from duty-free shops, where the customer does not take possession of the goods before leaving New Zealand (for example a duty-free shop may arrange to send goods to the airport for a traveller to pick up at the time of departure);
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(e) If a shop has been licensed by the Customs Service to operate a sealed bag system, goods given to the customer in New Zealand can be zero-rated. In this situation, the customers cannot use the goods until they leave the country;

(f) Goods sold by duty-free shops which are licensed as export warehouses and which operate within the Customs processing area at international airports, although GST may be payable at Customs upon entry to New Zealand.

See Inland Revenue Booklet GST Guide (IR375).

580.34  Boats and aircraft exported under their own power [s 11(1)(i), (7), (8), (9)]

The sale of a boat or aircraft to a purchaser, who then exports it under its own power to a place outside New Zealand, is zero-rated. However, the boat or aircraft must leave New Zealand within 60 days of the time the purchaser (or their agent) takes delivery, otherwise the supply will be subject to GST at the standard rate.

The 60-day period may be extended if Inland Revenue is satisfied that circumstances beyond the control of the supplier and purchaser have prevented, or would prevent, the export within the 60 day period. The application by the supplier Inland Revenue for an extension must be in writing and include documentation in relation to: records of the sale, limitations on dealings in and the uses that the boat or aircraft will be put to before export, and the proposed and actual date of export.

Inland Revenue [see TIB vol 19:3 (April 2007) at 22] requires the supplier to keep the following documentation to support the zero-rating of the exported boat or aircraft:

(a) A written statement from the purchaser that the boat or aircraft is not intended for use within New Zealand and that they will be exported from New Zealand;

(b) A written statement from the purchaser that the boat or aircraft will not be hired or given away before it is exported (however, they may be used as security for financing arrangements);

(c) A written statement from the purchaser that, if the boat or aircraft is offered for sale while it remains in New Zealand, it will be exported under its own power before completion of the sale;

(d) A record of the sale; and

(e) A copy of the “certificate of clearance” document issued to the purchaser by New Zealand Customs upon leaving New Zealand or other documentation that proves the boat or aircraft has left New Zealand. If the certificate is not available, the CIR may accept other documentation (eg the “entry for export” documents issued by the foreign customs authority evidencing arrival of the boat, or evidence of foreign registration of the boat).

580.35  Goods not situated in New Zealand at the time of supply [s 11(1)(j)]

Goods that are situated outside New Zealand at the time they are supplied and that are not going to be imported into New Zealand are zero-rated. For example, the supply of goods in Japan by the Japanese branch of a New Zealand company would be zero-rated. Because the New Zealand company is registered for GST the supply is a taxable supply, but it is zero-rated because the goods are not situated in New Zealand at the time of supply.

580.36  Goods and services used in relation to temporary imports

[ss 11(1)(h), (k), (ka), 11A(1)(h), (k), (i)]

Goods supplied in the course of repairing, renovating, modifying, or treating goods in transit through New Zealand and goods temporarily imported into New Zealand, that are consumed or become incorporated into the goods being repaired, are zero-rated. Where the goods being repaired are goods in transit, the supply is zero-rated only if the goods being repaired are not removed from the ship or aircraft on which they arrived in New Zealand. Typical examples of such zero-rated goods are spare parts supplied to repair the engine or equipment on board a foreign fishing vessel, materials consumed in repairing a cargo container, and medical supplies used to treat livestock in transit on a foreign ship or aircraft.
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Services supplied in relation to goods in transit through New Zealand and goods temporarily imported into New Zealand are also zero-rated. Where the goods are in transit, zero-rating only applies if the goods are not removed from the ship or aircraft in which they arrived.

**Example 1:**
A vet treats a thoroughbred horse on board an aircraft that has stopped off in New Zealand en route from Sydney to Hawaii. The fee charged by the vet will be zero-rated.

**Example 2:**
A marine engineer makes repairs to a launch visiting New Zealand under a temporary import entry. The engineer’s fees would be zero-rated.

Inland Revenue requires a copy of the Import Entry form issued by Customs to be kept by any person supplying goods or services in relation to a temporary import.

The CIR’s interpretation of these provisions (particularly as they apply to yachts and other vessels) is set out in TIB vol 10:11 (December 1998) at 22-24. The key points of the interpretation statement are as follows:

(a) To be zero-rated, non-consumable goods must be fastened to, or become part of, the temporary import. For example, cabin fittings or engine parts would be zero-rated, but not life jackets. Ropes are only zero-rated if they form part of the rigging.

(b) Zero-rating does not apply to goods in respect of which the supplier has claimed a secondhand goods input tax credit [see 580.123].

(c) In order to be zero-rated, services must be performed directly in connection with the temporarily imported vessel (eg painting, mechanical work, or hull repairs). Marina space or storage facilities for overseas yachts are considered to be supplied directly in connection with the vessels.

(d) The supplier must provide evidence such as the following to support a claim for zero-rating:
   (i) A copy of the recipient’s passport (note that the previous requirement that the recipient of the services be a non-resident ceased to apply from 10 October 2000);
   (ii) A copy of the NZ Customs Service temporary import entry permit;
   (iii) Details of the goods and services supplied (eg by way of invoices and photographs); and
   (iv) Evidence to show that those goods became part of the temporary import or were consumed in the process (eg by an explanation of the work done).

Refer to the interpretation statement for full details of the CIR’s interpretation and a detailed example.

From 24 October 2001, zero-rating also applies to goods that are supplied for use on, or the use of, a pleasure craft, where that pleasure craft is a temporary import. To qualify for zero-rating, they must be goods that cause or enable the craft to sail, or goods that ensure the safety of passengers and crew on the craft [s 11(1)(ka)]. Examples of such goods include sails, spinnaker poles, lights for navigation and safety purposes, anchors, life rafts, tenders, life buoys, sheets and halliards.

Evidence required to support the claim for zero-rating include:

(a) A copy of the TIE permit, issued by the Customs Service;
(b) A copy of the recipient’s passport;
(c) Details of the goods purchased;
(d) If available, a copy of the Customs certificate of clearance.

The final provisioning of consumable stores supplied to a foreign-based pleasure craft that is departing New Zealand may also be zero-rated under s 11(1)(l) [see 580.39].

580.37 Going concerns [ss 11(1)(m), 78E]

When a taxable activity [see 580.95], or a part of a taxable activity, is sold to a registered person as a going concern, the supply is zero-rated provided the supplier and the purchaser have agreed in writing that the
supply is of a going concern. The test for whether or not a going concern is to be transferred is applied at the
time of supply.

**TaxNote:** The supplier must be registered in order for the supply of a going concern to be zero-rated. This
is because, to be zero-rated, a supply must first be taxable, and to be taxable, the supply must be made by a
registered person.

To be a going concern, a supply must meet all of the following conditions [s 2(1)]:

(a) There must be the supply of a taxable activity, or of part of a taxable activity, capable of separate
operation;

(b) Everything necessary for the continued operation of the taxable activity (or part thereof) must be
supplied to the purchaser; and

(c) The supplier must carry on the taxable activity up to the time it is transferred to the purchaser.

Section 11(1)(m) requires that the supplier and the purchaser agree in writing that the supply is of a going
concern.

**Example:**
A beef and sheep farm is sold and the land, livestock, buildings, and machinery are included in the sale. The vendor continues
to run the farm up to the settlement date. The sale of the farm qualifies as the sale of a going concern. If only the land and
buildings were sold, and the machinery and the livestock were retained by the vendor, the sale would not qualify as a going
concern. It is not necessary that the purchaser actually continue to operate the taxable activity that has been transferred. So, for
instance, it would not matter if the purchaser had the intention of undertaking a dairy conversion and carrying on the activity of
dairy farming rather than drystock farming.

When a supply is treated as a going concern in error, and the agreement for the supply makes no provision
for the recovery of uncharged GST, s 78E enables the supplier to recover the GST from the purchaser by
increasing the consideration for the supply by 15 per cent (12.5 per cent prior to 1 October 2010). For further
examples, see TES 43 (November 2006) 659.

1) **Case law**

In *TRA Case N17* (1991) 13 NZTC 3,148, the subdivision of an eight-hectare block, including a house, from
152-hectare block and its subsequent sale was held to be still a going concern or part of a taxable activity as
a going concern and capable of separate operation. The purchasers acquired the vendor’s farming operation
in that they took over the taxable activities as well as the capital asset of land and buildings for agricultural
use.

In *TRA Case N3* (1991) 13 NZTC 3,021, it was held that the transfer of an individual fishing quota and a
fishing vessel was not a sale of a going concern.

In *TRA Case P38* (1992) 14 NZTC 4,288, the sale of a developing motel was not deemed to be the sale of a
going concern in that the vendors had been developing a new activity rather than operating a going concern.

In *Belton v Commissioner of Inland Revenue* (1997) 18 NZTC 13,403 (HC), the sale of the land, buildings,
and chattels of a motel, under a contract which provided for vacant possession, was held not to be the sale
of a going concern despite the fact that the motel was capable of being run as a going concern immediately
following settlement. The motel did not continue in its operation uninterrupted; at settlement date the motel
had been closed down and there were no future bookings.

In *TRA Case T63* (1998) 18 NZTC 8,480, the sale of the land, buildings and some of the plant of a joinery
business to a registered person was held not to be the supply of a taxable activity as a going concern. Although
the new owner subsequently used some of the plant to set up a different type of joinery business, the old
joinery business ceased to operate at the time the purchaser took possession. The purchase and sale agreement,
which was in a form used for the sale of land and buildings, expressed the price to be inclusive of GST (if
any) and the agreement did not mention the words “going concern”, nor did it provide for goodwill, restraint
of trade, stocktaking, preservation of stock levels, perusal of business records and financial accounts, the
employment of staff or for any work on hand.
In Commissioner of Inland Revenue v Fatac Ltd (in liq) (2001) 20 NZTC 17,348 (HC), the High Court found that the relevant taxable activity was the licensing of land and not quarrying as found by the TRA. The licence between the vendor and the third party had not been transferred on settlement. Had a lease been assigned to the purchaser, the goods and services necessary for the continued operation of the taxable activity would have been supplied. Also at issue was whether or not the parties had agreed that there be a transfer of a business as a going concern. This analysis was confirmed by the Court of Appeal in Fatac Ltd (in liq) v Commissioner of Inland Revenue (2002) 20 NZTC 17,902 (CA).

In Mortre Holdings Ltd v Starrenburg (2004) 21 NZTC 18,536 (HC), the High Court cited Fatac with approval when ordering the plaintiff to pay damages as a result of a breach of a warranty that they were registered for GST when, in fact, they were not.

(2) Commercial buildings

In 1989, Inland Revenue set a threshold of 80 per cent of the floor area of a commercial building which must be tenanted in order for the supply of the building to be a going concern. Following cases such as TRA Case M89 (1990) 12 NZTC 2,556 and TRA Case N38 (1991) 13 NZTC 3,322, Inland Revenue accepted that the 80 per cent threshold was too high and issued a new guideline setting a threshold of 50 per cent of rentable floor area, with effect from 1 April 1992. However, even this 50 per cent figure has subsequently been challenged in the Courts.

In TRA Case S27 (1995) 17 NZTC 7,189, the sale of a commercial rental property, which was 42 per cent tenanted, with a 58 per cent vacancy of a temporary nature that was merely part of the ordinary letting cycle, was accepted as the sale of a going concern.

The sale of a commercial building which was untenanted at the time of settlement was not the sale of a going concern even though: the building was tenanted at the time the contract was entered into; the contract referred to the sale as being zero-rated because it was a going concern; and the taxpayer had fully intended to carry on the business of producing rental income: TRA Case S91 (1996) 17 NZTC 7,573. The judgment summarised six principles relevant when deciding whether the sale of a commercial property is that of a going concern:

(a) There must be some undertaking happening on the land at the time of the agreement for sale and purchase;
(b) That undertaking must be of a business or commercial nature;
(c) The undertaking must be in existence and operating before, during, and after the sale;
(d) The inquiry as to whether there is a going concern must be into the substance of the transaction, not the form. Statements of intent in a contract are relevant but not conclusive;
(e) The transfer of the business activity itself, rather than simply the transfer of assets, is crucial in determining whether there has been the transfer of a going concern; and
(f) The relevant time to determine whether a going concern exists is the date the purchaser takes over the assets.

In New Zealand Guardian Trust Ltd v Commissioner of Inland Revenue (1996) 17 NZTC 12,506 (HC), the sale of a commercial building under an agreement which provided for vacant possession was not the sale of a going concern even though the tenant remained in the building after settlement date and paid rent to the new owner on an informal, monthly basis.

In Tepe Holdings Ltd v Commissioner of Inland Revenue (2010) 24 NZTC 24,551 (HC), the taxpayer was the lessor of a floor in a commercial building, holding shares in the office owning company. The taxpayer subleased that floor to tenants. It then entered into an agreement with another company to sell its shares in the office owning company. The taxpayer claimed that transaction was the sale of a going concern and therefore zero rated for GST purposes. The High Court held that the transaction entered into by the taxpayer was the sale of the shares of a company and was not the supply of a going concern. The Court of Appeal in Tepe Holdings Ltd v Commissioner of Inland Revenue [2011] NZCA 534 upheld that decision.
580.38  **New fine metal** [s 11(1)(n)]

The first supply of new fine metal following refining by a refiner to a dealer in fine metal is zero-rated if it is to be used by the dealer as an investment item. Where a person is both a refiner of and a dealer in fine metal, the new fine metal is deemed to have been supplied to a dealer immediately prior to the making of any exempt supply of that new fine metal.

For the definition of “fine metal”, see 580.26. New fine metal means fine metal that has been refined into fine metal by a refiner.

580.39  **International transportation** [s 11A(1)(a)-(d), (l)]

A supply is zero-rated if it involves the transport of passengers or goods:

(a)  From New Zealand to an overseas destination, or vice versa; or

(b)  Between two destinations, both outside New Zealand.

Zero-rating applies to both air and sea transport. The insurance and arranging of international transportation are also zero-rated. Travel between New Zealand and the Cook Islands, Niue, or Tokelau is not zero-rated because these islands are considered to be part of New Zealand.

International passenger transport includes any internal air travel within New Zealand that is part of the international carriage. Before 26 March 2003, this applied only to passenger travel by air. From 26 March 2003, it also applies to domestic legs of a cruise, provided that either the first place of departure or the final place of destination, is outside New Zealand.

**Example 1:**
A cruise commences in Sydney, docking in two other Australian ports before crossing the Tasman sea to dock in three New Zealand ports before finally terminating in Auckland. As the first place of departure is outside New Zealand, the cruise is zero-rated.

**Example 2:**
A person living in Invercargill wishing to fly to Melbourne may need to fly to Christchurch first to catch an international flight. Provided both legs of the flight are booked at the same time through the same travel agent, the Invercargill-Christchurch leg will be treated as part of the international flight and will be zero-rated.

When the services involve the international transport of goods (including ancillary transport activities such as loading, unloading and handling), transportation within New Zealand is also zero-rated where the transport is part of the international transport and the same person supplies the internal and international transport.

**Example 3:**
Manufactured goods are exported to Australia. One freight company is retained to transport the goods from the factory in Hamilton to the final destination in Australia. The services supplied by the freight company to the manufacturer, including transport and handling within New Zealand, qualify for zero-rating.

From 25 November 2003, the transport of household goods within New Zealand (including ancillary transport activities), is zero-rated where:

(a)  The services are supplied to a non-resident who is outside New Zealand at the time of supply;

(b)  The goods are entered for home consumption; and

(c)  The supply arrangement is made before the goods are entered and the services are expected to be completed within 28 days of the goods being entered.

A port company’s supply of storage facilities to non-residents does not qualify for zero-rating [see TIB vol 6:5 (November 1994) at 2].

The supply of goods which are consumable stores for use as stores for consumption outside New Zealand on an aircraft going to a destination outside New Zealand, or on a fishing ship going outside New Zealand fisheries waters, or on a foreign-going ship, is zero-rated under s 11(1)(l). This would include such things as fuel, food and beverages, fishing bait, and other stores that are expected to be consumed during the voyage.
The supply of goods are zero-rated where they are consumable stores for use on:
(a) An aircraft going to a destination outside New Zealand;
(b) A fishing ship outside, or going outside, New Zealand fisheries waters;
(c) A ship (other than a pleasure craft) carrying consumables to a foreign-going ship or fishing ship that meets the requirements of (a) or (b) above; or
(d) An aircraft going to a destination outside New Zealand [s 11(1)(l)].

This includes fuel, food and beverages, fishing bait, and other stores that are expected to be consumed during the voyage.

580.40 Services in connection with property situated outside New Zealand [ss 11A(1)(e)-(f)]

Services supplied directly in connection with land (including improvements such as buildings) situated outside New Zealand are zero-rated.

Example 1:
A New Zealand architect designs a building to be constructed on an overseas property for an overseas client. The charge for this service is zero-rated.

In Malololailai Interval Holidays New Zealand Ltd v Commissioner of Inland Revenue (1997) 18 NZTC 13,137 (HC), it was held that a supply will not be zero-rated under s 11(2)(b) unless the contractual arrangement between the parties evidences the direct supply by the supplier (ie not through a third party) of the services in connection with land.

Services supplied directly in connection with moveable personal property (excluding choses in action) situated outside New Zealand at the time the services are performed are zero-rated. Moveable personal property is any property other than land and improvements.

Example 2:
A New Zealand insurance company insures a vehicle which is located outside New Zealand. The premiums are zero-rated.

580.41 Services performed outside New Zealand [s 11A(1)(j)]

Any services physically performed outside New Zealand are zero-rated, provided that the nature of the services are such that they can be received at no place or time other than that at which they are performed.

Example:
A New Zealand doctor, who is registered for GST, goes to Western Samoa to treat patients there. The fees charged to those patients are zero-rated. In contrast, a lawyer who travels to Western Samoa to write a report for a New Zealand client would not be able to zero-rate the fee on the basis that the service was performed outside of New Zealand. The condition regarding place and time applies from 1 January 2005.

580.42 Services supplied to non-residents [ss 8(2), 11A(1)(g), (k), (2), (3)]

Many services supplied to non-residents are able to be zero-rated. However, a number of special rules apply to specific types of transaction.

Services supplied to non-residents who are outside New Zealand at the time the services are performed are zero-rated. For example, a charge for legal advice given to a person living in Australia by a lawyer resident in New Zealand is zero-rated.

Where the non-resident is a company or an unincorporated body, that entity will be considered to be outside New Zealand if its presence in New Zealand is of a minor nature and is not effectively connected with the supply. For example, if services are being supplied to a foreign company and, at the time of the supply, one of the company’s employees is in New Zealand for a few days working on a matter unrelated to the services being supplied, the company will be considered to be outside New Zealand at that time. The CIR has considered the presence of the non-resident purchaser in relation to short films made in New Zealand where the non-resident collects the film cassette and physically takes it overseas. The CIR considers the non-
resident’s presence in New Zealand to be sufficiently minor as to not impact on the ability of the New Zealand film maker to zero-rate the supply of the film making services [see TIB vol 19:1 (February 2007) at 47]. Zero-rating does not apply where an agreement is entered into with a non-resident person (person A) and the services are received in New Zealand by another person (person B), including:

(a) An employee of person A; or
(b) If person A is a company, a director of the company; and
(c) If it is reasonably foreseeable, at the time at which the agreement is entered into, that person B will not receive the services in the course of making taxable or exempt supplies.

Zero-rating does not apply to the following types of services:

(a) Services supplied directly in connection with land and improvements situated in New Zealand;
(b) Services supplied directly in connection with moveable personal property (excluding choses in action, temporary imports and goods in transit) situated in New Zealand at the time of supply;
(c) Agreeing to refrain from carrying on a taxable activity inside New Zealand.

The CIR has issued a binding ruling BR Pub 10/09 in relation to legal services provided to non-residents relating to transactions involving land in New Zealand. The ruling covers the following types of transaction:

• transactions involving the sale or purchase of land in New Zealand or the lease, licence, or mortgage of land in New Zealand;
• easements, management agreements, construction agreements, trust deeds, guarantees and other agreements concerning land in New Zealand; or
• disputes arising in relation to land in New Zealand.

The ruling concludes that the following types of legal services, provided to a non-resident who is not in New Zealand at the time at which the service is performed, and in relation to the above types of transaction are zero-rated under s 11A(1)(k) of the GST Act:

• legal services relating to transactions involving the sale and purchase of land in New Zealand, including the drafting of agreements for the sale and purchase of land, the provision of legal advice in relation to the sale and purchase transaction and ancillary and related services leading up to the completion of the sale and purchase transaction;
• legal services relating to transactions involving the lease, licence, or mortgage of land in New Zealand;
• legal services relating to easements, management agreements, construction agreements, trust deeds, guarantees and other agreements relating to land in New Zealand; and
• legal services relating to disputes arising in relation to land in New Zealand, including drafting court documents, court appearances, representation in negotiations and settlements and general advice in relation to such disputes.

The ruling applies from 23 May 2010 to 23 May 2015. The full text of the ruling, including commentary and examples, can be found in TIB vol 22:9 (October 2010) at 2-9.

More specific rules apply to the following types of service:

1) Airport operators’ terminal services charges

Airport operators’ terminal services charges and international garbage disposal charges are not zero-rated, but international airport dues and landing costs are: Auckland Regional Authority v Commissioner of Inland Revenue (1994) 16 NZTC 11,080 (HC).

2) Delivery of postal articles

Services that are supplied to overseas postal organisations for the delivery in New Zealand of postal articles mailed from outside New Zealand may be zero-rated.
**Example:**
A parcel is posted in the United States addressed to a New Zealand recipient. The US postal company receives payment for the cost of postage. Once the parcel has reached New Zealand, it is delivered to the recipient by New Zealand Post. If New Zealand Post charges the US postal company for the delivery within New Zealand, the charge may be zero-rated.

(3) **Advertising**

The supply of advertising space in a publication or advertising time on radio, television or other broadcasting service (including the communication of the advertising message and all steps involved in providing the service by the supplier of the advertising) is zero-rated if the service is supplied contractually for and to a non-resident who is outside New Zealand at the time the service is performed. Such supplies are not regarded as being “directly in connection with” land or moveable personal property in New Zealand. The supply is zero-rated even if a New Zealand resident also benefits from the advertising [see public ruling BR Pub 03/03, TIB vol 15:5 (May 2003) at 7-12].

Zero-rating also applies to creative services and placement services supplied to non-residents who are outside New Zealand at the time the services are performed, regardless of whether or not the goods to be advertised are situated inside New Zealand [see TIB vol 11:1 (January 1999) at 30-31].

(4) **Facilitation services provided by inbound tourism operators**

“Facilitation services” are services that a registered person provides in packaging one or more domestic tourism products, such as meals, transport and other activities, in New Zealand and selling them outside New Zealand to a non-resident person.

To the extent to which a supply of services consists of facilitation services, it is chargeable with GST at the standard rate and cannot be zero-rated. This treatment has been backdated to 1 July 2007. However, a transitional provision applies to relieve the transition to the new rule. Under the transitional provision, facilitation services are zero-rated for the period 1 July 2007 to 30 June 2008.

The consideration that relates to these services must be quantified for each GST period that falls within the transitional period. Where a GST period includes days that fall both within and outside of the transitional period, the consideration must be apportioned on a day-by-day basis. Quantification must be based on the person’s gross margin attributable to the facilitation of inbound tour operations or by some other means that the CIR is able to verify.

Where a registered person has paid GST in respect of the supply of facilitation services during the transitional period, the person is entitled to a refund of that GST. Applications for a refund must be made in writing to the CIR by 7 June 2010.

580.43 Exported information services [s 11A(1)(1), (2), (3)]

The supply of information to a non-resident who is outside New Zealand can be zero-rated if the information has a direct connection with moveable personal property in New Zealand as the services are regarded as being consumed offshore. However, zero-rating does not apply if the services are received by a person other than the purchaser and that person is in New Zealand at the time at which the services are performed.

Where the non-resident is a company or an unincorporated body, that entity will be considered to be outside New Zealand if its presence in New Zealand is of a minor nature and is not effectively connected with the supply [see 580.42].

Zero-rating does not apply to exported information in relation to land in New Zealand.

**Example 1:**
The provision to a non-resident of testing services on goods brought into New Zealand for the purposes of the testing activity would be zero-rated.

**Example 2:**
The provision of educational services in New Zealand to the child of a non-resident would not be zero-rated as the services are consumed in New Zealand.
Example 3:
The provision of architectural services in relation to a building situated in New Zealand would not be zero-rated as it is relation to land in New Zealand.

In *Auckland Institute of Studies Ltd v Commissioner of Inland Revenue* (2002) 20 NZTC 17,685 (HC), the taxpayer ("AIL") was a private educational institute that provided tuition services to overseas students. In 1993, the institute incorporated a subsidiary, AIS International Ltd ("AISI") to carry out its overseas activities. AIL provided the actual tuition services under subcontract to AISI. Under the arrangement, AISI was not able to charge a margin on the fee, but was able to charge an “assistance fee” for assistance with translation services, immigration procedures and the completion of enrolment applications. The assistance fee was not separately charged but, instead, was included in a global fee covering both the tuition and the assistance. The taxpayer sought to apportion the fee between the assistance component, which was to be zero-rated, and the tuition fee which was not. The CIR conceded that the assistance services could be zero-rated and suggested that 10 per cent of the fee could be apportioned to that component. AIS objected to the apportionment ratio. Hansen J found that the services provided to students comprised a single supply of tuition services and that no portion could be zero-rated. He held that, when considering whether a supply could be apportioned for GST purposes, it is necessary to examine the true and substantial nature of the consideration given to determine whether there is sufficient distinction between the allegedly different parts to make it reasonable to sever them and apportion accordingly. He found that all of the services were an integral part of the tuition services. Students had contracted for tuition, not for the assistance services. There was a single supply and no portion of it was able to be zero-rated. Hansen J went on to add that, had apportionment been available, it could have been calculated on the basis of the actual cost of providing the service plus a reasonable allowance for profit.

580.44 Services in connection with exported goods [s 11A(1)(m)]

Services supplied directly in connection with exported goods which themselves are zero-rated under any of paragraphs (a)-(e) of s 11A(1) are also zero-rated.

Example:
A non-resident purchases in New Zealand a piece of machinery that is to be shipped by the supplier to the purchaser’s home country. The purchaser requests that, prior to shipping, the machine be painted and signwritten. The services supplied by the painter and signwriter would be able to be zero-rated.

580.45 Supplies of property rights [s 11A(1)(n)-(p), (4)]

The following services in respect of the supply of rights are able to be zero-rated:

(a) The filing, prosecution, granting, maintenance, transfer, assignment, licensing, and enforcement of intellectual property rights, including patents, designs, trademarks, copyrights, plant variety rights, know-how, confidential information, trade secrets and similar rights.

(b) Other services in respect of the rights listed above, including making searches, giving advice, opposing a grant, seeking the revocation of the rights, and opposing steps taken to enforce the rights. These services are able to be zero-rated only where either: (i) the rights are for use outside New Zealand; or (ii) the services are supplied to a non-resident of New Zealand who is outside New Zealand when the services are performed.

(c) Services that are the acceptance of an obligation to refrain from pursuing or exercising, in whole or in part, the rights listed above. However, this applies only where and to the extent to which the rights are for use outside New Zealand.

(d) Services that are the acceptance of an obligation to refrain from carrying on a taxable activity if the activity would have occurred outside New Zealand.

580.46 Warranty payments from non-resident warrantors [s 11A(1)(ma)]

The supply of services to a non-registered offshore warrantor, in relation to goods sold in New Zealand which were subject to GST on importation and which are covered by a warranty agreement is zero-rated with effect
from 1 August 2002. The effect of the legislation is to remove the double tax impost that occurred as a result of the decision in the case of *Suzuki New Zealand Ltd v Commissioner of Inland Revenue* (2001) 20 NZTC 17,096 (CA). The amendment relieves non-registered offshore warrantors from the GST cost arising from the fact that they are not able to recover the GST on the cost of the remedial services. The term “warranty” is defined as “an undertaking given under a supply agreement to remedy any defect in the goods that appears during a certain period of time after the goods are supplied or before a certain level of usage is reached”. A supply of such services is treated as being the only supply of services in respect of the consideration supplied by the warrantor. If goods are supplied under the warranty (eg spare parts), the supply of those goods is treated as being a supply of services for the purposes of the provision.

**580.47 Telecommunication Services** [ss 2, 8(3), 8(4), 8A, 11A(5), 11AB, 51(1)(e)]

From 1 July 2003, new rules apply to cross-border supplies of telecommunication services. The changes have been made to cope with difficulties in determining where the services are physically performed and the identification of the party to whom the services are being supplied.

(1) **Place of supply — the “physical location” test**

There is deemed to be a supply in New Zealand when a person (other than a telecommunications supplier) who is physically in New Zealand initiates a supply of telecommunications services from a supplier outside New Zealand.

(2) **Place of supply — the “billing address” test**

Where the physical location test is not practical to use for a class of customer or service, there is deemed to be a supply in New Zealand when a person with a billing address in New Zealand initiates the supply from a telecommunications supplier outside New Zealand. The billing address is the physical location of the business or residence of the person and does not include a post office box number. Where the “billing address” test is used for a member of a class of customer or service, it must be used consistently for all members of that class of customer or service.

(3) **The initiator test**

In order to apply either of the above two tests, it is necessary to determine who has initiated the supply. In determining who has initiated a supply, the factors to be taken into account are:

(a) The person who controls the commencement of the service;
(b) The person who pays for the service; and
(c) The person who contracts for the supply.

Where more than one of these test is met, it is the test that is highest on the list that takes priority.

(4) **Zero-rating**

Telecommunications services are able to be zero-rated only under the following two circumstances:

(a) Telecommunication services supplied by a New Zealand telecommunications supplier to a non-resident telecommunications supplier when the service is initiated outside New Zealand; and

(b) Telecommunication services supplied to a non-resident person other than a telecommunications supplier when the service is initiated outside New Zealand.

All other telecommunications services will be either subject to GST under the tests outlined above or will be outside the scope of the GSTA because they are not deemed to be supplied in New Zealand.

A supply of telecommunications services from a non-resident to a registered person in New Zealand who would be entitled to an input tax credit are not subject to GST unless the supplier and recipient agree otherwise.

(5) **Registration**

Where a foreign telecommunications supplier makes more than $60,000 of supplies to persons in New Zealand within a 12-month period (formerly $40,000, before 1 April 2009), the supplier will be required to register for GST. However, a non-resident supplier is not required to register where the threshold is breached.
solely as a result of supplies deemed to be made in New Zealand under the “physical location” or “billing address” tests. This ensures that non-resident cellular phone companies are not forced to register for GST solely because they make supplies to non-resident customers who are “roaming” in New Zealand.

The CIR has issued an operational statement which provides guidelines regarding the GST treatment of cross-border supplies of telecommunications services [see TIB vol 18:3 (April 2006) at 13-24 and TIB vol 18:4 (May 2006) at 18 for diagram correction].

580.48 Emissions trading [ss 11, 11A]

Almost all transactions in emissions units are zero-rated. Specifically, the following transactions related to the emissions trading scheme are zero-rated:

(a) The transfer of the emissions unit (other than by the Crown) under s 64, or Part 4, subpart 2 of the Climate Change Response Act 2002 or under a covenant entered into under the Forests (Permanent Forest Sink) Regulations 2007 [s 11A(1)(s)].

Section 64 of the Climate Change Response Act relates to emissions units allocated by the Crown in consideration of a person’s removal activities which result in greenhouse gases being removed from the atmosphere, or not released into the atmosphere. Part 4, subpart 2 relates to emissions units allocated by the Crown to certain industry groups.

(b) The surrender of an emissions unit under s 63 of the Climate Change Response Act 2002 [s 11A(1)(t)];

(c) Services supplied free of charge to or by the Crown in consideration for a supply that is zero-rated under (a) or (b) above [s 11A(1)(u)];

(d) Goods supplied free of charge to or by the Crown in consideration for a supply that is zero-rated under (a) or (b) above [s 11A(1)(o)];

(e) The sale or other disposal of an emissions unit, other than the transfer from the Crown for nil consideration [s 11A(1)(v)];

(f) The sale or other disposal of a unit that:
   • Is not an emissions unit;
   • Has been verified to an internationally recognised standard; and
   • Has been issued by reference to the sequestration or avoidance of emission of human-induced greenhouse gasses [s 11A(1)(v)].

The following is a summary of the GST treatment of various transactions under the Emissions Trading scheme:

(1) Zero-rated supplies

The following transactions are zero-rated:

(a) Transactions involving New Zealand units, Kyoto-compliant units and approved overseas units:
   (i) Transfer of emissions units by Government under s 64 or Part 4, subpart 2, of the Climate Change Response Act 2002;
   (ii) All supplies of services (deemed or actual) made in exchange for emissions units transferred by Government under s 64 or Part 4, subpart 2, of the Climate Change Response Act 2002;
   (iii) Surrender of emissions units under s 63 of the Climate Change Response Act 2002;
   (iv) Supply of New Zealand units and Kyoto-compliant emissions units not involving the Government.

(b) Transactions involving voluntary units:
   (i) All supplies of voluntary units;

(c) Transactions outside of the emissions trading scheme:
   (i) Transfer of emissions units by Government under a Permanent Forest Sink Initiative (PFSI);
(ii) Supply of services (deemed or actual) made in exchange for emissions units transferred by the Government under PFSI.

(2) Non-zero-rated supplies
The following transactions are standard-rated:
(a) All supplies of services (deemed or actual) made in exchange for voluntary units;
(b) Transfer of emissions units by Government other than under s 64 or Part 4, subpart 2, of the Climate Change Response Act 2002 or PFSI (for example, Project to Reduce Emissions (PRE)).
(c) A supply of goods and services by one business to another in exchange for a supply of emissions unit.

(3) Recent changes in treatment
The GST treatment of the following transactions has changed:
(a) All supplies of emissions units, and all supplies of services (deemed or actual) made in exchange for emissions units were standard-rated until 1 January 2009. Services supplied by one business to another in exchange for emissions units are again standard rated from 1 July 2010;
(b) All supplies of voluntary units were standard-rated until 1 April 2010;
(c) Transfer of emissions units by Government other than under s 64 or Part 4, subpart 2, of the Climate Change Response Act 2002 (for example PFSI, PRE and NGA) were zero-rated from 1 January 2009 to 6 October 2009;
(d) Supplies of services (deemed or actual) made in exchange for emissions units transferred by Government other than under s 64 or Part 4, subpart 2, of the Climate Change Response Act 2002 (for example, PFSI, PRE and Negotiated Greenhouse Agreements) were standard-rated from 1 January 2009 to 6 October 2009. They are again standard rated from 1 July 2010.

580.49 Land [ss 2, 5, 11, 20, 25, 51B, 60B, 75, 78F]
From 1 April 2011, the supply of land is zero-rated where certain conditions are met. Zero-rating also applies where the supply has land as a component. In this case, it is the entire supply, and not just the land component, that is required to be zero-rated.
Where services are part of the supply that includes land, the services are deemed to be goods and are zero-rated along with the rest of the supply [s 11(8C)].
Where a transaction involving land is entered into before 1 April 2011, and the time of supply is 1 April 2011 or later, the supplier has the option of using either the old rules or the new rules for that supply [s 11(8C)].

(1) Conditions for zero-rating to apply [s 11(1)(mb)]
Zero-rating applies where all of the following conditions are met:
(a) The supply is a supply of land or a supply that includes land;
(b) Both the supplier and the recipient are registered persons;
(c) The recipient intends to use the goods (the land and anything sold with it) for making taxable supplies;
(d) The recipient does not intend to use the land as the “principal place of residence” for the recipient or any relative of the recipient.

The requirement that the recipient intend to use the goods for making taxable supplies is satisfied even where the recipient also intends to use the goods, or some of them, for making non-taxable supplies. In this case, the recipient is required to make an output tax adjustment to account for the non-taxable use [s 20(3)].
These conditions must be satisfied at the time of settlement [s 11(8B)]. If any of the conditions is not met, the supply is chargeable with GST at the standard rate.
Where a supply includes land that is:
Goods and Services Tax

(a) Intended to be used as the principal place of residence by the recipient or relative of the recipient; and
(b) The “principal place of residence” is included in a larger supply of land; the supplier is required to treat the supply of the residence as a separate supply. That separate supply is not subject to zero-rating [s 5(15)].

(2) Land definition [s 2]
The definition of “land” is repealed in respect of supplies made on or after 1 April 2011. From that date, the ordinary meaning of the work applies. A savings provision applies where a person has taken a tax position:

(a) For an adjustment period that ends before the date on which the Taxation (Tax Administration and Remedial Matters) Bill 2010 receives Royal assent;
(b) In relation to an adjustment for concurrent uses of land; or
(c) Relying on the definition prior to its repeal.

Prior to repeal, “Land” was defined to include:

(a) An estate or interest in land (this includes both legal and equitable interests);
(b) A right that gives rise to an interest in land (this includes a “profit à prendre”);
(c) An option to acquire land or an estate or interest in land;
(d) A share in the share capital of a flat-owning or “office-owning company” (as defined in s 121A of the Land Transfer Act 1952);
(e) A share in the share capital of a flat-owning or office-owning company.

“Land” did not include:

(a) A mortgage;
(b) A lease of a dwelling;
(c) An interest in land in circumstances where the supply is made periodically and 25 per cent or less of the total consideration specified in the agreement, in addition to any regular payments, is paid or payable under the agreement in advance of or contemporaneously with the supply being made.

The exclusion in (c) ensures that a lease of residential or commercial land is not “land” for the purposes of zero-rating unless there are large up-front payments.

(3) Obligations of the recipient of the supply [s 78F]
The supplier is required to base the decision as to whether or not the supply is required to be zero-rated on the registration status and the intentions of the recipient. To facilitate this decision-making, the recipient is required to give the supplier certain information. The information is required to be given in writing at or before settlement. The required information is that, at the date of settlement, the recipient:

(a) Is, or expects to be, a registered person;
(b) Is acquiring the goods with the intention of using them for making taxable supplies; and
(c) Does not intend to use the land as a principal place of residence for the recipient or a relative of the recipient.

As the information may be supplied before settlement, the recipient is able to supply it on the basis of the best estimate of what the situation will be as at the date of settlement. For example, a recipient who is not registered for GST may indicate that they intend to be registered as at the date of settlement. If the purchaser is acquiring the land on behalf of a nominee, the information given is that which pertains to the circumstances of the nominee. Where the sale is a sale in satisfaction of debt, such as a mortgagee sale or sale of repossessed goods, the information is given to the lender.

The recipient is required to supply their registration number to the supplier at or before the settlement date. If the supply is being made to an agent acting on behalf of an undisclosed principal, the requirement will be
met if the agent provides a written statement to the supplier as to whether, as at the date of settlement, the principal:

(a) Is, or expects to be a registered person; and
(b) Is acquiring the goods or services with the intention of using them for making taxable supplies; and
(c) Does not intend to use the land as a principal place of residence for themselves or a person associated with them.

The agent is also required to provide their own registration number to the supplier on or before settlement date.

(4) Obligations of the supplier [ss 75, 78F]

The supplier is able to act on the basis of the information supplied by the purchaser. The supplier has no obligation to make any attempt to verify the information. However, if the supplier has reason to suspect that the information is not correct, the supplier may, but is not obliged to, use the GST treatment that they believe to be correct. This could arise, for example, where the purchaser has stated in writing that they do not intend to use the property as their principal place of residence, but the supplier has reason to believe that they intend to use it for that purpose. If the purchaser does not supply the required written information, the supplier should not zero-rate the supply [s 78F].

If the supply is zero-rated, s 75(3B) requires the supplier to maintain records of the following particulars in relation to the supply:

• The name and address and registration number of the recipient;
• A description of the land; and
• The consideration for the supply.

Where the supply is made to a person who is acting as agent for an undisclosed principal, the supplier will have met the requirements if they maintain sufficient records to enable the name, address and registration number of the agent to be ascertained. The agent is required to maintain sufficient records for the name, address and registration number of the principal to be ascertained.

(5) Where the wrong GST treatment is used

The time of supply may be earlier than the date of settlement. This could arise where, for example, there is a binding contract in place, a tax invoice has been issued, and the supplier is required to account for GST on the invoice basis. The recipient of the supply may have provided information that, while correct at the time of supply, is incorrect at the time of settlement.

For example, the recipient may have stated that they intend to be registered for GST as at the date of settlement but, for some reason, the registration has not occurred. Or the recipient may have stated that they intend to use the property for the making of taxable supplies but have changed their mind and zero-rating is now known not to be the correct treatment. Conversely, the original information may have meant that the supply should not be zero-rated but the new information means that it should be zero-rated, such as when the recipient becomes registered for GST when they had originally not intended to do so.

Where the new information comes to light before settlement, the parties are permitted to agree to correct the GST treatment but are not obliged to do so. If a tax invoice has already been issued, the supplier would need to issue:

• A credit note, where the transaction has been standard rated and should be zero-rated; or
• A debit note, where the transaction has been zero-rated but should be standard-rated.

Where a credit note is issued, it provides the basis for the supplier to claim back any GST that has been remitted to Inland Revenue. The claim is made by way of an adjustment in the supplier’s GST return. The credit note also creates an obligation for the purchaser to repay any GST that has been claimed as a deduction. Where a debit note is issued, the opposite applies but the purchaser will not be able to claim GST as either
they are not registered for GST, their intention is not to use the property for making taxable supplies, or they intend using the property as a principal place of residence for themselves or a relative.

Where the matter is corrected after settlement, a credit note will need to be issued if the supply should have been zero-rated but was not. This will allow the supplier to claim back the GST if they have already remitted it to Inland Revenue. The purchaser won't have claimed GST on the purchase (it would have been zero-rated had the purchaser been registered and had the intention of using the property for making taxable supplies) and so need take no further action.

If, after settlement, it transpires that the transaction should have been standard rated but has occurred on the basis that it is zero-rated, the purchaser is treated as having made a supply of the goods at standard rate. This deemed transaction occurs on the date of settlement [s 5(23)]. If the purchaser is not registered, they will be treated as being registered as from the date of supply and are required to apply for registration. As this may result in the GST being paid late, use-of-money interest and penalties may apply. Once the GST has been accounted for, the person is able to request de-registration [s 51B]. Provided the request for de-registration is made by the end of the taxable period in which the deemed output tax is remitted to Inland Revenue, and the CIR agrees, the deemed sale of all goods and services forming part of the assets of the taxable activity that normally occurs on de-registration, will not occur.

Where the purchaser is subject to the deemed supply provisions of s 5(23), they are denied a corresponding input tax deduction [s 20(4B)]. However, a deduction may be allowed at some later date if the goods are then used in making taxable supplies.

Example 1:
Ben owns a small farmlet on which he carries on horticultural activities. Ben lives on the property and is registered for GST. Ben sells the property to Gemma who initially does not intend to use it for carrying on a taxable activity. The house and curtilage is valued at $450,000 and is required to be treated as a separate transaction for GST purposes. The selling price of the entire property is $800,000 plus GST if any.

Ben issues a tax invoice for $902,500 made up of $450,000 for the house and curtilage (which is not subject to GST and $452,500 ($350,000 plus GST of $52,500) for the remainder of the property). Ben remits the output tax of $52,500 to Inland Revenue. Prior to settlement, Gemma changes her mind and decides to carry on a taxable activity on the property. She registers for GST and informs Ben of the change. Ben and Gemma agree to correct the GST treatment before settlement.

Ben issues a credit note for $52,500 and uses this as the basis for an adjustment in his next return, claiming the $52,500 of GST that he has previously paid. Gemma pays Ben the new figure of $800,000 and, as the house and curtilage is not subject to GST and the balance of the transaction is zero-rated, she makes no claim in her GST return.

Had the change in circumstances occurred before settlement but either had not been notified to Ben before settlement or the parties had not agreed to amend the treatment before settlement, Ben will still need to issue a credit note in order to claim back the GST that he has paid to Inland Revenue. If Gemma has already claimed the GST at the time of supply, she will need to repay it and the credit note will crystallise this obligation. Gemma will also be keen to recover the GST that she paid to Ben on settlement. Commercially, this is unlikely to occur until Ben has successfully claimed the amount from Inland Revenue.

Example 2:
Catherine owns and operates a motel complex. She sells the property to Jason for $3,000,000 plus GST if any. Jason advises in writing that he intends to use the property for making taxable supplies, will be registered for GST at the time of settlement and does not intend to use the property as the principal place of residence of himself or any relative. The supply is, therefore, zero-rated. Just before settlement, Jason advises Catherine that he has had a change of plan and intends to turn the motel into apartments. Catherine has already issued a tax invoice showing the property as zero-rated and the time of supply has, therefore, occurred. The parties agree to correct the GST treatment prior to settlement. Catherine issues a debit note and Jason pays Catherine the GST inclusive price of $3,450,000. Catherine will account to Inland Revenue for the GST. Jason will not be entitled to make claim the GST that he has paid as he will not be using the property for making taxable supplies.

If the treatment is not changed at settlement, Jason will be required to register and will be deemed to have made a taxable supply of the property as at the date of settlement. After he has accounted for the GST to Inland Revenue, he will be able to de-register. Provided de-registration occurs prior to the end of the period in which he pays the GST to Inland Revenue, he will not have a deemed disposal of all of the assets.

(6) Nominee transactions

Where a purchaser nominates another person (a nominee) to be the recipient of the land, that nominee is deemed to be the purchaser and the GST treatment is based on the circumstances of the nominee. The
provision does not apply to supplies made by or to agents. Neither do they apply to other types of transaction such as assignments or novations [s 60B].

In the event that the transaction is not zero-rated, the tax invoice for the supply could be in the name of the purchaser who acquired the property on behalf of the nominee. In this case, it is essential that the nominee maintain records of:

- The name and address of the supplier;
- The date on which payment for the land was made;
- A description of the property; and
- The amount paid for the property.

Failure to maintain the records will preclude any input tax deduction or input tax adjustment being made in respect of the land [ss 20(2)(d), 24(7B)].

580.50 Place of supply [s 8(2)]

GST is charged only on goods and services supplied in New Zealand. A supply is deemed to take place in New Zealand if the supplier is resident in New Zealand.

A supply is deemed to take place outside New Zealand (and therefore is not a taxable supply) if the supplier is not resident in New Zealand, unless the goods are in New Zealand at the time of supply, or the services are physically performed by a person who is in New Zealand at the time of performance. However, if goods and services supplied in New Zealand by a non-resident are supplied to a registered person, the supply is deemed to be outside New Zealand unless the supplier and recipient agree otherwise in writing.

For GST purposes, the term "resident" has the same meaning as in the ITA [see 1250 RESIDENCE], except that it also includes:

(a) A person carrying on any taxable or other activity in New Zealand through a fixed or permanent place in New Zealand; and

(b) An unincorporated body that has its centre of administrative management in New Zealand [s 2].

580.60 Value of supply [s 10]

The value of a supply determines the amount of GST charged on it. For example, if the value of the supply is $100, the GST charged is 15 per cent of $100, or $15 (prior to 1 October 2010, the rate was 12.5 per cent). The rules for determining the value of a supply vary depending on the type of supply and who the supply is made to. However, as a general rule, the value of a supply is the consideration for that supply (excluding GST). Where the consideration received for the supply is in a foreign currency, the value of supply is the (GST-exclusive) amount of foreign currency converted to New Zealand dollars. The exchange rate required to be used is the “buy rate” offered by an approved bank or bureau de change at the time of supply. Any foreign exchange fluctuation is regarded as being part of the supply and is not regarded as being a separate (exempt) supply [see public ruling BR Pub 04/01 (expired 1 March 2004), TIB vol 16:2 (March 2004) at 3-6].

In the vast majority of cases, the value of the supply will be the amount paid for the supply, less the GST. The value of a supply is the GST-exclusive amount, whereas the consideration includes the GST. This can be expressed as follows:

\[
\text{Consideration} = \text{value of supply} + \text{GST}
\]

Applying this to the previous example, the value of the supply is $100, the GST is $15 and the consideration is $115. The GST component of the consideration is easily calculated by multiplying the consideration by three-twenty-thirds (known as the “tax fraction”).

“Consideration” includes both monetary and any non-monetary consideration, and is defined in s 2 to include any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person.
In *TRA Case T61* (1998) 18 NZTC 8,461, the issue of paid up shares in part consideration for the purchase of a commercial property was held to constitute “consideration in money” under s 10(2). The vendor of the building was required to account for GST on the entire sale price of the property including the shares received. Where the consideration is non-monetary, the open market value of the consideration determines the value of the supply. See 580.63 for a discussion of the meaning of “open market value”. The one exception to this rule relates to emissions units. Where:

(a) The supply is the right to receive a certain number of emissions units at a future date;
(b) The supplier and recipient are not associated; and
(c) Each is either making a taxable supply or acquiring a taxable supply for use in making taxable supplies.

The value of the supply is the amount agreed to by the parties.

The CIR has issued four public binding rulings regarding the GST implications where property is sold and the rates either have been prepaid or are in arrears. Public ruling BR Pub 10/10 relates to the GST implications for the vendor where the rates have been paid for a period beyond settlement. Public ruling BR Pub 10/11 relates to the GST implications for the purchaser where the rates have been paid for a period beyond settlement. Public ruling BR Pub 10/12 relates to the GST implications for the vendor where the rates are in arrears. Public ruling BR Pub 10/12 relates to the GST implications for the purchaser where the rates are in arrears. In each case the ruling considers whether payment by the purchaser to the vendor for prepaid rates, or a reduction in the amount paid by the purchaser where the rates are in arrears, gives rise to output tax payable by the vendor and input tax claimable by the purchaser.

In the case of rates paid beyond settlement, the CIR concludes that the payment by the purchaser for the apportioned amount of the prepaid rates is part of the consideration for the supply of the property. Therefore, if the purchaser is GST-registered, and is entitled to an input tax claim in respect of the property, the claim will be based on the total consideration paid, including the amount for rates. Similarly, the vendor’s liability for output tax will be based on the total amount. In the case of rates arrears where the purchaser agrees to pay the outstanding amount, the consideration for the purchase is the sum of the purchase price plus the rates debt taken over by the purchaser. Again, the GST obligations of both parties is based on this total amount. The four rulings, together with worked examples can be found in TIB vol 22:10 (November 2010) at 3 - 16.

(1) *Supplies to associated persons [ss 10(3), (3A)]*

If a supply is made to an associated person [see 580.65] for a consideration in money that is less than the open market value of the supply, the consideration for the supply is deemed to be its open market value. However, the open market value is not used if:

(a) The supply is a fringe benefit provided or granted by the supplier to a person employed under a contract of service; or
(b) The supplier and the associated person are both registered for GST, and the associated person acquired the supply for the principal purpose of making taxable supplies and is able to claim an input tax deduction for it.

In *TRA Case T12* (1997) 18 NZTC 8,070 an unregistered farm owning company had leased a farm to an associated person of the company for less than its market rental. In fact the open market rental was well in excess of the GST registration threshold. The farm owning company was therefore deemed to be registered. In *TRA Case M110* (1990) 12 NZTC 2,704, where a sale between associated persons was at a value greater than the open market value, the CIR was not permitted to reduce the value of the supply to the open market value.

**580.62 Value of supply — summary**

The following table is a summary of the various value of supply rules in s 10. The appropriate subsection should be referred to for full details of these rules.
### Goods and Services Tax

<table>
<thead>
<tr>
<th><strong>Type of supply</strong></th>
<th><strong>Section</strong></th>
<th><strong>Value of supply</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Consideration for the supply to the extent it is in money [see 580.60].</td>
<td>10(2)</td>
<td>Amount of the consideration, excluding GST.</td>
</tr>
<tr>
<td>Consideration for a supply by way of payment in a foreign currency.</td>
<td>10(2)</td>
<td>The amount of foreign currency converted to New Zealand dollars at the time of supply.</td>
</tr>
<tr>
<td>Consideration for a supply to the extent it is non-monetary [see 580.60].</td>
<td>10(2)</td>
<td>Open market value of the consideration, excluding GST.</td>
</tr>
<tr>
<td>Supply made to an associated person for no consideration or for a consideration that is less than the open market value of the supply, and the supply is not a fringe benefit [see 580.65, TES 5 (June 2003) 64].</td>
<td>10(3)</td>
<td>Open market value of the consideration, excluding GST.</td>
</tr>
<tr>
<td>Above type of supply, when acquired for principal purpose of making taxable supplies, and recipient is entitled to an input tax deduction.</td>
<td>10(3A)</td>
<td>Normal value of supply rules per s 10(2).</td>
</tr>
<tr>
<td>The export (and thus zero-rating) of goods purchased secondhand by a registered person, for which an input tax deduction has been claimed.</td>
<td>10(4)</td>
<td>Purchase price paid by the supplier (not reduced by the amount of the input tax deduction).</td>
</tr>
<tr>
<td>Goods and services supplied under a credit contract (as defined in the Credit Contracts Act 1981), or at the option of the taxpayer (s 7 of the Credit Contracts and Consumer Finance Act 2003).</td>
<td>10(5)</td>
<td>Purchase price to that the associated person (not reduced by the amount of the input tax deduction).</td>
</tr>
<tr>
<td>Accommodation (excluding food) in a commercial dwelling (hotel, motel, etc) [see 580.66].</td>
<td>10(6)</td>
<td>Cash price, excluding GST, or the price that the customer would have been charged for the goods or services but for the credit contract (ie the interest and credit charges are not included in the value of the supply). First four weeks — amount of consideration, excluding GST. Period in excess of four weeks — 60% of consideration, excluding GST.</td>
</tr>
<tr>
<td>Accommodation (excluding food) in a residential establishment for an agreed period of 4 weeks or more [see 580.66].</td>
<td>10(6)</td>
<td>60 per cent of consideration, excluding GST.</td>
</tr>
<tr>
<td>A supply of goods and services which is a fringe benefit (excluding exempt or zero-rated supplies).</td>
<td>10(7)</td>
<td>Taxable value of the fringe benefit, per s ND 1.</td>
</tr>
<tr>
<td>Goods and services deemed to be supplied upon cessation of registration [see 580.84].</td>
<td>10(7A), (8), 5(3)</td>
<td>Market value. But assets acquired prior to 1 October 1986 are valued at the lower of GST-inclusive cost and open market value. The lesser of the original GST-inclusive cost of the goods and services acquired principally for making taxable supplies [see 580.126].</td>
</tr>
</tbody>
</table>
**580.63 Open market value** [s 4]

The open market value of a supply of goods and services is determined according to the following rules.

(a) The open market value at any date is the consideration in money which the supply of goods and services would fetch if sold in similar circumstances in New Zealand at that date, being a supply freely offered and made between unassociated persons.

(b) If the open market value cannot be determined under (a), the open market value is the consideration in money which a similar supply would fetch if sold in similar circumstances in New Zealand at that date, being a supply freely offered and made between unassociated persons. A “similar supply” is defined as a supply of goods and services which is the same as, or closely or substantially resembles, the supply in question in respect of its characteristics, quality, quantity, functional components, materials and reputation.

(c) If the open market value cannot be determined under (a) or (b), the open market value is determined in accordance with a method approved by the CIR. The method must provide an objective approximation of the consideration in money which could be obtained for that supply.

(d) The open market value of a non-monetary consideration is determined in the same way as for a monetary consideration under (a) to (c), with any necessary modifications.

The CIR’s policy on determining “open market value” is set out in TIB vol 6:14 (June 1995) at 6-8.

In *TRA Case T12* (1997) 18 NZTC 8,070 an unregistered farm owning company had leased a farm to an associated person of the company for less than its market rental. In fact the open market rental was well in excess of the GST registration threshold. As a result, the farm owning company was deemed to be registered.

**580.64 Apportionment** [ss 5(14), 10(18)]

When a supply is partly zero-rated and partly standard-rated, or partly taxable and partly exempt, the supply or the consideration for it must be apportioned between the various parts. The two main provisions dealing with apportionment are ss 5(14) and 10(18).

Under s 5(14), when a supply is partly standard rated and partly zero-rated, each part of the supply is treated as a separate supply.
Example 1:
A travel agency bills a business client for air travel within New Zealand and a return air trip to London. The two trips are unrelated. The total value of the travel supplied is $3,000, of which $700 relates to travel within New Zealand. For GST purposes, the overseas travel (being zero-rated) is treated as one supply and the travel within New Zealand (being standard rated) is treated as another. The value of the zero-rated supply is $2,300 and the value of the standard rated supply is $700.

Under s 10(18), when consideration is provided which relates partly to a taxable supply and partly to some other matter, the consideration must be apportioned between the taxable supply and the other matter. The taxable supply is deemed to be for such portion of the consideration as is properly attributable to it.

Example 2:
A customer pays an insurance company an annual premium of $5,000 for a special executive insurance plan which provides life insurance, superannuation and medical insurance cover. As life insurance and superannuation are exempt supplies, only the portion of the premium which relates to medical insurance is the value of the taxable supply. The portion of the premium which relates to each type of cover is:

<table>
<thead>
<tr>
<th>Type of Cover</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life insurance</td>
<td>$800</td>
</tr>
<tr>
<td>Superannuation</td>
<td>$3,000</td>
</tr>
<tr>
<td>Medical insurance</td>
<td>$1,200</td>
</tr>
</tbody>
</table>

The consideration must be apportioned between the taxable supply ($1,200) and the non-taxable supply ($3,800).

Example 3:
Where a taxpayer carries on the business of financing finance leases, expenditure on goods acquired for leasing will give rise to an input tax deduction. However, goods and services acquired for general business use will need to be apportioned [see Binding Ruling BR Pub 96/11 (expired 31 March 2000)].

A special apportionment provision [s 5(15)] deems a dwelling to be a separate supply when it is included as part of a supply [see 580.16].

580.65 Associated persons [s 2A]
Associated persons or persons associated with each other are:

(a) Two companies, if a group of persons (as defined in s YA 1) has:
   (i) Voting interests in each of those companies of 50 per cent or more when added together; or
   (ii) Market value interests in each of those companies of 50 per cent or more when added together, and a market value circumstance (as defined in s YA 1) exists in respect of either company; or
   (iii) Control of each of those companies by any other means whatsoever.

(b) A company and a person other than a company, if the person has:
   (i) A voting interest in the company of 25 per cent or more; or
   (ii) A market value interest in the company of 25 per cent or more, and a market value circumstance exists in respect of the company.

Under paras (a) and (b) above, any two persons who are associated under the remainder of the paras below are treated as holding anything held by the other of them. For example, if a husband and wife each holds a 13 per cent interest in a company, they are both associated persons of the company as each is deemed to hold not only their own shares but also those held by their spouse.

(c) Two branches or divisions of a person that are each treated as a separate person under s 56B.

(d) Two persons who are:
   (i) Connected by blood relationship;
   (ii) Connected by marriage, civil union or de facto relationship; or
   (iii) Connected by adoption.
(e) A partnership and a partner in the partnership.
(f) A partnership and a person, if the person is associated with a partner in the partnership.
(g) A trustee of a trust and any person who is associated by blood, marriage, adoption, etc, with another person who is associated with the trustee due to their having benefited or being eligible to benefit under the trust.
(h) A trustee of a trust and a person who has benefited or is eligible to benefit under the trust, except if, in relation to a supply of goods and services:
   (i) The trustee is a charitable or non-profit body with wholly or principally charitable, benevolent, philanthropic or cultural purposes; and
   (ii) The supply is made in carrying out those purposes or the supply enables them to carry out those purposes.
(i) A trustee of a trust and a settlor of the trust (other than a charitable trust or a charitable non-profit body with wholly or principally charitable, benevolent, philanthropic or cultural purposes).
(j) A trustee of a trust and a trustee of another trust if the same person is a settlor of both trusts except where, in relation to a supply of goods and services:
   (i) Either trustee is a charitable or non-profit body with wholly or principally charitable, benevolent, philanthropic or cultural purposes; and
   (ii) The supply is made in carrying out those purposes or enable them to be carried out.
(k) A person (“A”) and another person (“B”) if:
   (i) B is associated with a third person (“C”) under any one of paras (a) to (j) above; and
   (ii) C is associated with A under any one of paras (a) to (j) above.

Persons are connected by blood relationship if they are within the second degree of relationship.

<table>
<thead>
<tr>
<th>Blood relationship</th>
<th>Degree of relationship</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parent or child</td>
<td>First</td>
</tr>
<tr>
<td>Grandparent, grandchild or sibling</td>
<td>Second</td>
</tr>
</tbody>
</table>

Persons are connected by marriage, civil union or de facto relationship if:

(a) One is in a marriage or civil union with the other;
(b) One is in a marriage or civil union with a person who is connected by blood relationship with the other; or
(c) One is in a de facto relationship, between a man and a woman, with the other.

Same gender de facto relationships are included in the definition with effect from 1 April 2007. For discussion regarding what constitutes a de facto relationship see TIB vol 17:4 (May 2005) at 6.

Persons are connected by adoption if one has been adopted as the child of the other or as a child of a person who is within the first degree of relationship to the other.

580.66   Accommodation in commercial dwellings [s 10(6)]

Special rules apply for valuing accommodation in commercial dwellings and residential establishments.

A “commercial dwelling” is defined as:

(i) A hotel, motel, homestay, farmstay, bed and breakfast establishment, inn, hostel, or boardinghouse;
(ii) A serviced apartment managed or operated by a third party for which services in addition to the supply of accommodation are provided and in relation to which a resident does not have quiet enjoyment, as that term is used in s 38 of the Residential Tenancies Act 1986;
(iii) A convalescent home, nursing home, rest home, or hospice;
(iv) A camping ground;
(v) Premises of a similar kind to those referred to in subparagraphs (i) to (iv).

It does not include:
(i) a hospital except to the extent to which the hospital is a residential establishment;
(ii) a dwelling situated in a retirement village or rest home if the consideration paid or payable for the supply of accommodation in the dwelling is for the right to occupy the dwelling.

This definition applies from 1 April 2011.

A “residential establishment” is any commercial dwelling in which at least 70 per cent of the occupants are expected to reside for a minimum period of four weeks. A hospital is a residential establishment if it is used to provide accommodation in a similar way.

A “hospital” is an institution that is a hospital care institution under the Health and Disability Services (Safety) Act 2001, or an institution whose principle purpose is to receive and treat people needing medical treatment or suffering from a disease. It includes all clinics, dispensaries, offices, outpatient departments, services, and undertakings, maintained in connection with, or incidental to, such an institution.

(1) Accommodation in a commercial dwelling

The amount of GST charged on accommodation supplied to an individual in a commercial dwelling depends on the length of the stay. If the length of the stay is less than four weeks, GST is charged on the full amount paid for the accommodation. If the length of stay exceeds four weeks, GST is charged on the full amount paid for the first four weeks’ accommodation and on 60 per cent of the amount paid for accommodation in excess of four weeks. GST at 15 per cent on 60 per cent of the value of the supply equates to an effective rate of GST of nine per cent. The 12.5 per cent GST rate that applied prior to 1 October 2010 would have given an effective rate of 7.5 per cent.

Example 1:
Horace stays in a motel for two weeks, paying a tariff of $490 (excluding GST) per week. Because Horace’s stay is for less than four weeks, he will be charged GST at 15 per cent on the full amount of $980 ($490 × 2), or $147.
Nancy stays in the same motel for six weeks, paying the same weekly rate. She will be charged GST at 15 per cent on the full tariff for the first four weeks and at 15 per cent on 60 per cent of the tariff for the last two weeks:
\[
\text{GST} = (490 \times 4 \times 15\%) + (490 \times 2 \times 60\% \times 15\%) = 294.00 + 88.20 = 382.20
\]

Using the same example and taking into account the increase in the GST rate to 15 per cent from 1 October 2010, the result is $980 x 15% or $147 in GST for Horace. For Nancy, the calculation is: ($490 × 4 × 15%) + ($490 × 2 × 60% × 15%) = $294 + $147 = $441.

The reduced rate of GST for periods in excess of four weeks applies only to the portion of the supply that relates to the actual accommodation (including cleaning, maintenance, electricity, gas, air conditioning, heating, telephones, television, radio or similar services). Goods and services not directly related to the supply of accommodation, such as meals, drinks and laundry are taxed in full at the standard rate.

(2) Accommodation in a residential establishment

The amount of GST charged on accommodation supplied to an individual in a residential establishment is 15 per cent (prior to 1 October 2010, 12.5 per cent) of 60 per cent of the tariff for the whole of the period of the stay, provided that the supplier and the recipient agree that the length of the stay is at least four weeks or, if there is going to be more than one period, that the total of all the periods will exceed four weeks.

As with commercial dwellings, the reduced rate of GST applies only to the portion of the supply that relates to the actual accommodation (including cleaning, maintenance, electricity, gas, air conditioning, heating, telephones, television, radio or similar services). Goods and services not directly related to the supply of accommodation, such as meals, drinks and laundry are taxed in full at the standard rate.
Example 2:
Alice stayed in a nursing home for six weeks to recover following major surgery. Ninety per cent of the patients who go to the nursing home stay for longer than four weeks. Alice was charged $6,300 for her room, $2,100 for meals and $400 for medication, excluding GST. Because Alice’s stay exceeded four weeks, GST will be charged on only 60 per cent of the value of her accommodation. GST will be charged as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Calculation</th>
<th>GST Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Room (accommodation)</td>
<td>$6,300 \times 60% \times 15%</td>
<td>$567.00</td>
</tr>
<tr>
<td>Meals</td>
<td>$2,100 \times 15%</td>
<td>$315.00</td>
</tr>
<tr>
<td>Medication</td>
<td>$400 \times 15%</td>
<td>$60.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>$942.00</strong></td>
</tr>
</tbody>
</table>

580.67  Tokens, stamps, vouchers and casino chips

In TIB vol 7:2 (August 1995) at 21-24, the CIR issued a policy on the GST treatment of tokens, stamps, vouchers, and casino chips.

Tokens, stamps, and vouchers are “chose in action” and, accordingly, “services” as defined in s 2. Therefore, the supply of a token, stamp, or voucher is a supply of services for GST purposes. The definition of “services” in s 2 specifically excludes the supply of goods or money. A chose in action is a personal right of property that can be claimed or enforced only by legal action. The holder of a token, stamp, or voucher is entitled to rights that cannot be enforced by taking physical possession. For example, if a retailer refused to convert a gift voucher into goods the holder of the voucher could only enforce compliance with legal action. The CIR accepts that tokens, stamps, and vouchers include such things as phone cards, rail passes, bus tickets, courier tickets, and gift vouchers.

From 10 October 2000, s 5(11E) and (11F) provides that the issue of a token, stamp, or voucher with a face value is treated as a supply. The redemption of the token, stamp, or voucher is not treated as a supply. Therefore, the treatment of a token, stamp, or voucher is the same as the treatment of the supply of any other good or service.

There are two exceptions to this rule. Firstly, the issue or sale of a token, stamp, or voucher by a registered person (Issuer 1) to another registered person (Issuer 2) who subsequently issues or sells it is not a supply unless Issuer 1 is the person who supplies the goods and services on redemption of the token, stamp, or voucher.

Secondly, s 5(11G) provides that where:

(a) It is not practical to treat the issue of a token, stamp, or voucher as a supply of goods and services; and

(b) The supplier of the goods or services specified in the token, stamp, or voucher and the issuer of the token, stamp, or voucher (who are, or could be, different persons) agree,

the redemption of the token, stamp or voucher, rather than its issue, may be treated as a supply. For the purposes of this exception, it is important to differentiate between the “issue” and the “sale” of a voucher. The exemption will generally apply only where the issuer and the redeemer of the voucher for goods or services are different persons and they have agreed to use the redemption basis. For example, a petrol voucher may be issued by the Motor Trades Association, sold to a customer by a BP service station, and redeemed by a Mobil service station. However, the redemption basis of recognition may be used where the issuer of the voucher and the supplier of the goods or services are the same person if it is not practicable to recognise the supply on the issue of the voucher.

In all cases, the input tax deduction for the registered person acquiring the token, stamp, or voucher will arise at the time at which the voucher is issued.

Section 5(11I) deals with postage stamps and ensures that, with effect from 3 April 2006, the sale of postage stamps connected with mail is subject to GST and cannot be zero-rated. The term “postage stamp” is defined in s 5(11I) as being an adhesive label; or a mark or design that is:

(a) Issued or sold by a person to another person;
(b) Affixed to, impressed on or printed on stationery;
(c) Indicates prepayment of the fee chargeable for the carriage of a letter, parcel or other article; and
(d) Not intended to distinguish the article to which it relates from similar articles carried by the same person (this is intended to differentiate between a postage stamp and labels such as PAT labels used by courier operators to identify the specific parcel).

Section 10(15A) specifically deals with casino chips. The combined effect of ss 10(15A) and 5(11B) is that the value of a supply made by a casino is the amount that the casino collects from a customer, less the amount that the casino pays to a customer as winnings or for the redemption of chips.

For the treatment of tokens, stamps, vouchers and casino chips prior to 10 October 2000 [see Staples Tax Guide (2005) 580.67].

**Example:**
A casino sells $1,000 of casino chips to a gambler who loses $900 of the chips. The last gamble of $100 of chips wins $300 plus the return of the stake. At the end of the night, the gambler collects winnings of $300 and cashes in the $100 in chips retained. The casino must account for GST of $66.67 on its supply to the gambler, the consideration for that supply being $600 (the $1,000 of chips, less the winnings of $300, less the redemption of chips of $100).

### 580.70 Time of supply [s 9]

The time at which a supply takes place is important because it determines the taxable period in which registered persons must account for GST on the supply.

Generally, a supply takes place when an invoice is issued for the supply, or when any payment is received by the supplier for the supply, whichever is the earlier.

**Example 1:**
Goods are delivered to a customer on 28 August, an invoice is issued on 2 September and the customer pays for the goods on 18 October. The time of supply is 2 September, being the earlier of when an invoice is issued and any payment is made.

A supply is deemed to take place when an invoice is issued. This applies whether the supplier or the recipient issues the invoice, and whether or not the invoice is a tax invoice [see 580.140].

**TaxNote:** The use of the words “any payment” means that the supply does not have to be paid for in full in order for the supply to have occurred. A deposit is sufficient.

**Example 2:**
A customer pays a 10 per cent deposit on 24 March, the goods are delivered on 27 April, an invoice is issued on 5 May and the customer pays the outstanding balance on 22 June. The time of supply is 24 March, being the earlier of when an invoice is issued and any payment is made.

The CIR’s policy on when an agreement for the sale and purchase of property is an “invoice” for tax purposes is set out in interpretation statement IS 07/02 [see TIB vol 19:7 (August 2007) at 7-8]. Under this policy:

(a) A conditional agreement for the sale and purchase of property does not constitute an invoice;
(b) A conditional agreement for the sale and purchase of property that becomes unconditional will not constitute and invoice; or
(c) An unconditional agreement for the sale and purchase of property does not constitute an invoice.

Therefore, unless an actual invoice is issued prior to any payment being made, the time of supply will be triggered by the first payment that is made in respect of the supply.

The CIR’s revised policy on the effect of the payment of a deposit on the time of supply is set out in Interpretation Statement IS 10/03. The revised policy applies from 27 May 2010. The Statement discusses the treatment of a deposit under the following three circumstances:

- A payment made under an unconditional contract;
- A payment made under a conditional contract;
- A payment made when no contract exists.
The conclusions are as follows:

(1) **Unconditional contracts**

Where the payment is made under an unconditional contract, there is a supply and the deposit is paid in respect of that supply. Section 9(1) will deem the time of supply to be when the deposit is received by the supplier. This will be so even if the goods or services have not been physically supplied or performed at that time. It is possible that there is more than one supply taking place and that there is a supply that occurs before the main supply ("a preliminary supply"). This might occur, for example, in the case of a wedding function where a preliminary supply relating to the securing of a particular date takes place before the main supply of the actual function. However, the CIR considers that this situation would be unusual.

(2) **Conditional contracts**

Where the payment is made under a conditional contract, a deposit is not received by a supplier as long as any person holds it as stakeholder, whether that person is the supplier or an independent third party. A deposit will not be received unless the supplier, or the supplier’s agent, receives it for his or her own benefit, or, in the case of a deposit paid to an agent, for the principal’s benefit. The CIR considers that the following requirements must be met in respect of the stakeholder:

(a) The essential requirement for a stakeholder relationship is the existence of an agreement between the parties. A person cannot establish himself or herself as a stakeholder unilaterally.

(b) A stakeholder is required to hold the funds until a defined event takes place. That event establishes who is entitled to the money. The parties have no proprietary interest in the funds until that event takes place.

(c) A person who holds money as a stakeholder does not act as agent for either party. A stakeholder, in their capacity as stakeholder, holds the funds for both parties and owes a contractual or quasi-contractual obligation to both parties. This is the case even if the person acting in the capacity of stakeholder is also acting in the capacity of agent for one or other of the parties.

(d) The entitlement to interest may be dealt with as a term of the stakeholding agreement between the parties and who is entitled to the interest on the deposit may, therefore, vary. If the supplier as stakeholder is entitled to the interest and the interest is applied to the purchase price, the interest will constitute a payment received by the supplier in respect of the supply and the time of supply will be triggered.

(e) The consent of both parties is necessary to vary a stakeholder’s obligations.

(f) The intention of the parties, determined from all the circumstances, will establish in which capacity a person receives the money.

(g) The existence of a separate bank account in which the funds are placed (although not a legal requirement) combined with clear written confirmation of the stakeholder relationship will generally support the contention that a person is a stakeholder.

(3) **Where no binding contract exists**

The mere receipt of payment will not necessarily indicate the existence of a taxable supply. If there is no supply, the payment cannot be consideration.

The full text of IS 10/03, including a number of examples can be found in TIB vol 22:6 (July 2010) at 7-16.

The CIR’s policy regarding time of supply where payment is made by cheque, credit card, or charge card is the subject of public ruling BR Pub 96/12 (expired 31 December 1999) [see TIB vol 8:10 (December 1996) at 10-13]. The main points of the ruling are set out below:

(a) Where payment is made by cheque, “payment” occurs when the cheque is handed over. If the cheque is subsequently dishonoured, payment has not occurred. This rule applies also to post-dated cheques.
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If the supplier and recipient are associated persons, evidence will be required as to the presentation and honouring of the cheque.

(b) Where payment is made by way of credit or charge card, “payment” occurs on the date on which the transaction takes place.

(c) Where payment is by way of irrevocable letter of credit, “payment” occurs on the date on which the provision of the letter of credit is accepted as performance or payment.

A practice known as pre-funding is prevalent in the shipping and port services industries. In this situation, the provider of a service requires payment before performing the service. When the prepayment is expressed as a percentage of the ultimate consideration, Inland Revenue considers the full consideration has been determined and a time of supply has occurred. GST is payable on the full value of the service at the earlier of the time the invoice requesting prepayment is issued or a payment is received. When the final consideration has not been determined, and cannot reasonably be determined, GST is only payable on the amount of the part-payment invoiced or paid. GST is payable on the balance of the supply when the final consideration is established and an invoice is issued or payment is received [see TIB vol 7:3 (September 1995) at 26-27].

Where the transaction is a barter transaction, “payment” is made at the time at which legal or equitable title in the property passes to the acquirer: *Lanauze v King* (2001) 20 NZTC 17,360 (HC).

580.72 Time of supply in special cases [s 9]

Some types of supply are subject to special time of supply rules. The following table summarises these rules. See s 9 for complete details.

<table>
<thead>
<tr>
<th>Type of supply</th>
<th>Section</th>
<th>Time of supply</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supplier and recipient are associated persons [see TES 5 (June 2003) 64].</td>
<td>9(2)(a)</td>
<td><em>Goods</em> — when the goods are removed or, if goods are not to be removed, when the goods are made available to recipient.</td>
</tr>
<tr>
<td></td>
<td></td>
<td><em>Services</em> — when the services are performed.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>If an invoice is issued or any payment is made on or before the return due date for the taxable period in which the goods were removed or made available or the services were performed, the general time of supply rule applies.</td>
</tr>
<tr>
<td>Door to door sale.</td>
<td>9(2)(b)</td>
<td>The day after the last day the purchaser may cancel the sale under the Door to Door Sales Act 1967.</td>
</tr>
<tr>
<td>Layby sale.</td>
<td>9(2)(c)</td>
<td>At the time the property in the goods passes to the purchaser. If the sale is cancelled, a supply of services (relating to the retention or recovery of amounts by the seller) takes place at the date of cancellation.</td>
</tr>
<tr>
<td>Bet on a race or sporting event.</td>
<td>9(2)(d)</td>
<td>When the money is dealt with as specified in the Gaming Duties Act 1971 or the Racing Act 2003.</td>
</tr>
<tr>
<td>Game of chance, lottery, New Zealand instant game, New Zealand lottery, New Zealand prize competition, or prize competition.</td>
<td>9(2)(e)</td>
<td>The date on which the first drawing or determination of the result of the game or lottery commences (this does not apply to New Zealand instant games or games of chance played by means of a gaming machine or an amusement device).</td>
</tr>
<tr>
<td>Type of supply</td>
<td>Section</td>
<td>Time of supply</td>
</tr>
<tr>
<td>--------------------------------------------------------------------------------</td>
<td>---------</td>
<td>--------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Coin- and token-operated devices.</td>
<td>9(2)(f)</td>
<td>At the time the coins or tokens are taken from the device by the supplier.</td>
</tr>
<tr>
<td>Casino games.</td>
<td>9(2)(g)</td>
<td>At the time a casino count takes place.</td>
</tr>
<tr>
<td>Goods on hire (but not on hire purchase).</td>
<td>9(3)(a)</td>
<td>On the earlier of when each payment becomes due or is paid. Each payment represents a separate supply.</td>
</tr>
<tr>
<td>Services supplied for periodic payments.</td>
<td>9(3)(a)</td>
<td>On the earlier of when each payment becomes due or is paid. Each payment represents a separate supply.</td>
</tr>
<tr>
<td>Goods supplied progressively for periodic payments.</td>
<td>9(3)(aa)</td>
<td>On the earlier of when each payment becomes due, or is paid, or an invoice relating to the payment is issued. Each payment represents a separate supply.</td>
</tr>
<tr>
<td>Goods and services supplied under a hire purchase agreement.</td>
<td>9(3)(b)</td>
<td>The date the hire purchase agreement is entered into.</td>
</tr>
<tr>
<td>Goods taken before price determined (but not goods on hire or goods supplied to an associated person).</td>
<td>9(6)</td>
<td>On the earlier of: when any payment becomes due, is received, or an invoice is issued.</td>
</tr>
<tr>
<td>Goods and services deemed to be supplied by a public authority when an amount is brought to charge as revenue from the Crown.</td>
<td>9(7)</td>
<td>The taxable period in which the supply is brought to charge.</td>
</tr>
<tr>
<td>Local authority rates.</td>
<td>9(8)</td>
<td>The time of supply for local authority rates is the earliest of:</td>
</tr>
<tr>
<td>Loyalty programme transactions.</td>
<td>9(9)</td>
<td>Under some circumstances, the time of supply of the sale of loyalty points can be deferred until the time at which the loyalty points are redeemed for a reward. This applies only where the criteria set down in s 11C are met (see below).</td>
</tr>
</tbody>
</table>

(1) **Loyalty programme transactions [s 9(9)]**

The aim of this provision (which applies from 6 October 2009), is to defer the imposition of GST until it is known whether or not a loyalty programme reward should be zero-rated or standard rated for example, a customer may redeem the loyalty points for international travel. International travel is generally a zero-rated supply. Conversely, the customer may redeem the loyalty points for a home appliance. The supply of that good is generally standard rated.

A “loyalty programme” is defined as a consumer incentive scheme under which a customer can obtain loyalty points that are redeemable for goods or services [s 2(1)].
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Where an operator of a loyalty programme enters into an arrangement with another person (the purchaser) through which the operator receives consideration for providing loyalty points to a third person as directed by the purchaser. The operator may defer the time of the supply of the services to the time at which loyalty points are redeemed.

In order for the deferral to be available, the following conditions must be met:

(a) Twenty-five per cent or more of the operator’s taxable supplies must be zero-rated supplies of goods or services. The 25 per cent threshold must be met for the 12-month period that ends with the month in which the supply of services under the loyalty transaction is made, and the operator must have reasonable grounds for believing the threshold will be met for the 12-month period that begins with the month in which that supply of services is made. The 25 per cent threshold may be met by including the taxable activity of an associated person; and

(b) Either the operator or an associated person of the operator must make supplies of goods or services in a business activity that is not the operating a loyalty programme and the loyalty points supplied by the operator must only be able to be redeemed for reward as part of the operator’s business activity. If the operator has a partner in an associated loyalty programme, this requirement is still treated as met if loyalty points supplied by the operator are able to be redeemed by the partner; and

(c) When the loyalty points are redeemed, the operator must be able to identify whether GST has been imposed on the supply of the loyalty points or whether the time of supply has been deferred under this provision.

580.80 Registration [s 51]

Any person carrying on a taxable activity [see 580.95] is liable to be registered for GST if either of the following conditions is satisfied:

(a) The total value of taxable supplies made by the person in New Zealand in any 12-month period in the course of the taxable activity has exceeded $60,000 (formerly $40,000, before 1 April 2009), and the total value of taxable supplies to be made by the person in New Zealand in the next 12 months in the course of the taxable activity is also expected to exceed $60,000.

(b) There are reasonable grounds for believing that the total value of taxable supplies to be made by the person in New Zealand in the next 12 months in the course of the taxable activity will exceed $60,000.

If a person is carrying on more than one taxable activity, it is the total value of taxable supplies made from all the activities that is considered when determining whether the $60,000 threshold has been exceeded.

A person becomes liable to register at the end of the 12-month period in which the $60,000 threshold has been exceeded, or at the start of the 12-month period in which the $60,000 threshold is expected to be exceeded.

A person is not liable to register for GST if the $60,000 threshold is exceeded solely as a result of the person:

(a) Ceasing to carry on, or substantially and permanently reducing the size or scale of, a taxable activity;

(b) Replacing any plant or other capital asset used in a taxable activity; or

(c) The supply to non-residents (who are physically present in New Zealand), of telecommunications services that are treated as being supplied in New Zealand under ss 8(6) and 8A.

For example, in TRA Case T3 (1997) 18 NZTC 8,014, the sale of a forest (for an amount exceeding the then-threshold of $30,000) before its maturity by an unregistered person was held to represent a premature cessation of the taxable forestry activity, and the owner was therefore not liable to register for GST.

For GST purposes, “person” includes not only an individual but also a company, an unincorporated body of persons, a public authority and a local authority. Registration thus applies to any entity likely to be carrying on a taxable activity, such as an individual, company, partnership, trust, club, association, school, university, Government department, or local authority. In Newman v Commissioner of Inland Revenue [2000] 3 NZLR 227, (2000) 19 NZTC 15,666 (HC), the High Court held that associated persons who acted together to supply goods valued above the threshold for registration should be treated as a single registered person.
and the taxable activities should therefore not be disaggregated. However, mere co-owners of land as tenants in common generally will not constitute a “body” for GST purposes. Where the land is leased out, compulsory registration will apply only where the rental income receivable by each particular co-owner is sufficient to breach the registration threshold. The application of these rules is discussed in public ruling BR Pub 97/11 (expired 31 March 2000) [see TIB vol 9:11 (November 1997) at 14-17]. Although this ruling expired on 31 March 2000 and has not been reissued, it does provide some guidance.

Any person liable to be registered must apply (on form GST1) for registration within 21 days of becoming liable to register.

**Example:**
Rachel commenced business as a self-employed hairdresser on 1 May and expects her turnover to be well in excess of $60,000 in the coming year. Rachel is liable to register on 1 May (the start of the 12-month period in which she expects taxable supplies to exceed $60,000), and she must apply to register within 21 days of that date.

Registration normally takes effect from the date of application although registration may be backdated in some circumstances.

“Registered person” is defined as a person who is registered or who is liable to be registered under the GSTA. The effect of this definition is that a person cannot avoid the obligations of being registered merely by failing to actually register. For example, in *Trustee, Executors and Agency Co New Zealand Ltd v Commissioner of Inland Revenue* (1997) 18 NZTC 13,076 (HC) the taxpayer (a trust) leased land to a lessee for $24,000 a year. The lessee also paid the rates on the property and accounting fees on behalf of the trust. The trust was not registered for GST. The land was subsequently sold and the purchaser claimed an input deduction for goods purchased secondhand from an unregistered supplier. The High Court held that the payment of the rates and accounting fees by the lessee was part of the consideration for the supply by the trust of the land. The total value of supplies made by the trust during the years in question therefore exceeded the then-threshold of $24,000 per annum, and the trust was liable to be registered retrospectively and to account for GST on the sale of the land, even though it had subsequently ceased to carry on a taxable activity.

If a person has not applied for registration and the CIR considers that the person should be registered, the CIR can register the person with effect from the date the person first became liable to be registered. However, the CIR has the discretion to register the person from a later date if that would be equitable.

From 1 April 2005, the following persons are deemed to be registered:

(a) Any unregistered person who supplies goods and services and represents to charge GST on them;

(b) Any person whose registration has been cancelled because they have not carried on a taxable activity since they were registered. Even though the person’s registration is cancelled retrospectively, the person is still deemed to have been a registered person from their original date of registration until the date their registration was cancelled, and the person must pay any GST represented to have been charged on any supplies made during that period;

(c) Any person selling goods in satisfaction of a debt, or the person whose goods are sold in satisfaction of a debt if they have supplied a written statement under s 5(2) and the CIR considers the statement to be incorrect.

(1) **Voluntary registration**

Any person carrying on a taxable activity may voluntarily register for GST, even if the total value of taxable supplies made is less than the registration threshold. A person can apply for registration in advance of commencing a taxable activity. For example, a person intending to commence trading from a certain date can apply, in advance, to be registered from that date.

The main advantage of voluntary registration is that a deduction can be claimed for GST paid on taxable supplies received. The main disadvantages are that the registered person must account for GST on all taxable supplies made, meet the record-keeping requirements [see 580.168] and file regular GST returns. As a general guide it is preferable, from a cash flow point of view, to be registered if standard-rated taxable supplies received exceed standard-rated taxable supplies made because this will result in regular GST refunds. For
example, a small, registered manufacturer which exports all its products will get a refund of all of the GST that it pays on its taxable expenses because its sales, being exports, are zero-rated.

2 Backdated voluntary registration

People who apply for voluntary registration may request that their registration be backdated. The CIR has issued a policy statement on backdating voluntary registration in TIB vol 7:3 (September 1995) at 14-16. Each request for backdated registration is dealt with according to the facts of that particular case. Generally, the CIR will select the date of application or a date in the future to be the date of registration, unless circumstances exist that justify registering the person effective from a previous date. The CIR will only register a person retrospectively when the circumstances show that it would be unfair on the taxpayer for the registration not to be retrospective. When considering whether to backdate the registration, the CIR may consider and weigh up various factors including:

(a) The reason why the applicant did not request registration at the time that registration was first desirable;
(b) Whether the applicant proceeded in business in the belief that he or she was ineligible to be registered;
(c) Whether the applicant considered that he or she had been registered automatically;
(d) Whether the applicant can substantiate the amount of output tax payable;
(e) The amount of time between the date of application and the date from which the applicant wishes to be registered; and
(f) The possible effect on the administration of the GSTA.

When the CIR backdates the registration, the applicant must return the output tax that should have been charged on past supplies made. Tax invoices must be issued to the recipients of the supplies made since the date of registration so that the recipients can claim GST input deductions in the current period. The applicant may also reduce the output tax by the amount of input tax paid for goods and services acquired for the principal purpose of making taxable supplies for that period, provided that the applicant has the relevant tax invoices.

580.82 Notification of change of status [s 53]

Registered persons must notify Inland Revenue in writing within 21 days of any of the following changing:

(a) Their name, address or constitution;
(b) The nature of their principal activity or activities;
(c) The address from which, or the name in which, any taxable activity is carried on;
(d) The registered person ceasing to qualify for a six-month taxable period because annual taxable supplies exceed $500,000 (formerly $250,000, before 1 April 2009);
(e) The registered person becoming required to have a one-month taxable period because annual taxable supplies exceed $24,000,000;
(f) The registered person ceasing to qualify to use the payments basis to account for GST;
(g) The registered person, being a member of a group of companies, ceasing to be eligible to be a member of the group.

A registered person who ceases all taxable activities, must notify Inland Revenue in writing within 21 days. If a registered person wishes to adopt or change the trading name used on their tax invoices and debit and credit notes, they must advise Inland Revenue of the new name and the date from which it will be used. No time period is specified for doing this.

580.83 Registration of non-residents

The provisions relating to registration do not distinguish between residents and non-residents. The requirement to register therefore applies equally to non-residents, on the basis of the rules explained in 580.80. Consequently, a non-resident carrying on a taxable activity (either inside or outside New Zealand) is required to register for GST if the total value of taxable supplies made in New Zealand has exceeded...
$60,000 in the previous 12 months, or will exceed $60,000 in the next 12 months. Similarly, a non-resident carrying on, or intending to carry on, a taxable activity may voluntarily register for GST if taxable supplies are less than $60,000 per year [see TIB vol 6:13 (May 1995) at 7-8].

The rules for determining when a supply by a non-resident is deemed to be made in New Zealand are set out in 580.50.

580.84 Cancellation of registration [ss 5(3), (3A), (7A), (8), (10), 52, 54, 58]

(1) Taxable supplies less than $60,000

A registered person may apply for their registration to be cancelled if the value of their taxable supplies in the subsequent 12-month period will be no more than $60,000 (formerly $40,000, before 1 April 2009). The application may be made either in writing or by telephone. Cancellation of registration is optional because persons making taxable supplies of less than $60,000 may voluntarily register so long as they are carrying on a taxable activity [see 580.95].

Before cancelling a person’s registration, Inland Revenue must be satisfied that taxable supplies will, in fact, be less than $60,000 during the next 12 months.

Cancellation normally takes effect from the last day of the taxable period in which the application is processed, although Inland Revenue may cancel the registration from another date. Inland Revenue must notify the person of the date that registration is cancelled.

Output tax is payable at the time of deregistration based on the market value of all goods other than those acquired by the taxable activity prior to the introduction of GST on 1 October 1986. Output tax is payable on goods acquired before 1 October 1986 based on the lesser of cost and market value.

In Lopas v Commissioner of Inland Revenue (2006) 22 NZTC 19,726 (CA), the Court of Appeal found that the CIR was entitled to re-exercise his power of cancellation of registration to amend the cancellation date. The taxpayers who owned a forestry property had deregistered as of 30 September 1999 under s 52(1) on the basis that their taxable supplies for the ensuing 12 months would be below the threshold. They paid output tax based on the cost price of the property. On 8 October, they entered into an agreement to sell the property to the family trust. The CIR was of the opinion that output tax should be paid on the sale price of the property, not its cost price. Consequently, he amended the deregistration date to 30 November.

In the High Court case of Thompson v Commissioner of Inland Revenue (2009) 24 NZTC 23,725 (HC), Dobson J concluded that the taxpayer was not entitled to deregister on 30 November 1999. The CIR’s assessment of output tax on two property transactions which occurred in December 1999 and March 2000 was upheld but the assessment in respect of a third sale in September 2000 was not. In the case of this third transaction, the Court found that the output tax should be returned in the taxpayer’s unregistered capacity.

His Honour found that the deemed supply on deregistration applies irrespective of whether the business is to cease on deregistration or continue in a reduced form below the registration threshold. He found that the Court of Appeal in Lopas had held that the proviso to s 51(1) (being the non-application of the requirement to register where the registration threshold will be exceeded only because of downsizing or cessation of the business, replacement of a capital asset or supply of telecommunication services to non-residents who are in New Zealand) applies only where the transaction would, for the first time, push the transaction level over the registration threshold. Therefore, in this case, the three land transactions were relevant to determining whether the scale of taxable activities would, in the future, exceed the registration threshold.

His Honour also noted that the Court in Lopas had held that, where transactions were planned as at the date of deregistration, the sale will be treated as part of the taxable activity. “Planned” requires an assessment of the facts of the case to determine whether the transactions are planned in a “sufficiently choate way that is to be seen as connected with the conduct of the business, even when it is being downsized”. Intention to sell will not be sufficient.

The case was appealed by the taxpayer with a cross appeal by the CIR in Thompson v Commissioner of Inland Revenue [2011] NZCA 132. The judgment of the Court of Appeal was that the test in s 52 is not whether the sale was “planned” or “contemplated”, but whether the CIR has reason to be satisfied that no transaction
would occur that would result in the total of all taxable supplies exceeding the registration threshold. The result of the appeal was that output tax was payable on the sale of all three sections. The Supreme Court has granted leave to appeal. The questions to be examined by the Supreme Court are:

(a) When did the appellant become entitled to be de-registered for GST purposes? and

(b) In the light of that determination, and the circumstances in which they took place, did the second and third sales of land attract GST?

(2) All taxable activities ceased

A registered person who ceases to carry on all taxable activities must notify Inland Revenue in writing within 21 days of the date of cessation. Cancellation normally takes effect from the last day of the taxable period during which all taxable activities cease, although Inland Revenue may cancel the registration from another date. Registration cannot be cancelled if the registered person is likely to recommence to carry on a taxable activity at any time within 12 months after the date of cessation.

The notice provided by the registered person must state:

(a) The date when all taxable activities ceased; and

(b) Whether or not the person intends to recommence any taxable activity within 12 months of that date.

Even if no cessation notice has been received from the registered person, Inland Revenue may still cancel a registered person’s registration if it is satisfied that the registered person is not carrying on a taxable activity. The registration will normally be cancelled with effect from the last day of the taxable period in which Inland Revenue made the decision to cancel the registration. Inland Revenue may cancel the registration from another date, including a retrospective date which is not earlier than:

(a) The last day of the taxable period during which the taxable activity ceased; or

(b) The date the person was registered, if the person has never carried on a taxable activity.

Inland Revenue must notify the registered person of the date cancellation takes effect.

(3) CIR discretion to deregister non-residents

The CIR has discretion to deregister a non-resident where they carry on a taxable activity overseas but do not carry on a taxable activity in New Zealand. The measure is designed to prevent such persons claiming GST refunds on such things as entertainment provided for no charge to New Zealand guests. The measure is not intended to apply to non-residents who are starting up a business in New Zealand but who have yet to make a taxable supply. Guidelines explaining the circumstances under which the discretion will be exercised have been issued [see TIB vol 17:7 (September 2005)]. The amendment applies to persons who register for GST on or after 21 June 2005.

(4) Consequences of ceasing to be registered

A person who ceases to be registered for GST needs to be aware of the following:

(a) The person must furnish a final GST return covering the period from the beginning of the final taxable period up to the date registration ceased. The return must be furnished by the last working day of the month after the month in which registration ceased.

(b) A person’s GST obligations and liabilities for the period for which the person was registered are not affected by the fact that registration is cancelled [s 54]. For example, if a person’s registration is cancelled, the person is still required to file all the necessary returns and pay any tax due in relation to all taxable periods up to the date their registration was cancelled.

(c) If the person retains any of the assets that were part of the taxable activity, GST must be accounted for on the value of those retained assets by way of an output adjustment in the final return. See below.

(d) All the accounting and business records relating to the taxable activity must be kept for at least seven years after the end of the taxable period in which registration ceased [s 75, see 580.168].
(5) Accounting for GST on assets held at cessation of registration

If a person ceases to be registered for GST, any goods and services used in the taxable activity and not sold prior to the cessation of registration are deemed to be supplied in the course of the taxable activity at the time registration ceases. Thus, for example, if a business carrying on a taxable activity subsequently ceases trading, the business must pay GST on the value of all the assets it owns as at the date of ceasing to be registered. For this purpose, the assets are valued at market value. However, where the assets were acquired prior to 1 October 1986, the assets are valued at the lower of their GST-inclusive cost and open market value [s 10(8)]. Open market value is explained in 580.63. The GST is accounted for by means of an output adjustment in the GST return [see 580.126].

The requirement that assets acquired on or after 1 October 1986 and retained on deregistration be adjusted for at market value rather than the lower of cost or market value applies from 10 October 2000.

A deemed supply does not occur if:

(a) A person carrying on a taxable activity dies, goes into liquidation or receivership, or becomes bankrupt or otherwise incapacitated, and a specified agent (personal representative, liquidator, receiver or agent) carries on the taxable activity in their stead. In these circumstances, the specified agent is deemed to be a registered person.

(b) A mortgagee takes possession of land or other property and carries on the taxable activity of the mortgagor. The mortgagee is deemed to be a registered person for the period the mortgagee is in possession of the land or other property [see 580.89].

580.85 Registration of branches and divisions [s 56]

A registered person carrying on a taxable activity in branches or divisions may apply in writing to register any of the branches or divisions separately if those branches or divisions maintain their own accounting system, and are in separate locations or carrying out different activities. The $60,000 registration threshold (formerly $40,000, before 1 April 2009), applies to the supplies across all branches or divisions and not each branch or division separately.

The consequence of separate registration is that each branch is treated separately from the parent body but must use the same taxable period and accounting basis as the parent, and must remain registered as long as the parent is registered. Supplies of goods and services between the parent and branches are fully taxable. If a branch or division fails to furnish returns or pay GST, the liability for these actions becomes the responsibility of the parent body.

The parent body may apply to have the separate registration of any branch or division cancelled. Cancellation is effective from the last day of the taxable period in which the application is made. If the parent body ceases to be registered, the separate registrations of all branches and divisions will also be cancelled.

580.86 Group registration [s 55]

(1) Companies

Two or more companies can apply (on form GST4) to Inland Revenue for GST group registration where they:

(a) Are a group of companies or part of a group of companies for income tax purposes [see 940.30]; or

(b) Would be a group of companies or part of a group of companies for income tax purposes were it not for the fact that one or more of the companies is a multi-rate PIE; or

(c) Would be a group of companies, or part of a group of companies, for income tax purposes were it not for the fact that one or more of the companies is a listed PIE.

One of the companies must be nominated as the representative member. Not all the companies in a group of companies need be included in a group registration. GST group companies are effectively treated as a single entity in relation to their intra-group supplies. The main effect of GST group registration is that intra-group transactions are not liable for GST.
Group registration is available where:

(a) Each of the companies in the group is a registered person; or

(b) At least 75 per cent by value of the total supplies made by the companies (in any consecutive 12-month period that includes that time) to persons outside the GST group are taxable supplies.

**TaxNote:** The 75 per cent test is continuous. If the group cannot meet the test at any particular time, its right to include a non-registered company within the GST group is forfeited. When determining whether or not the 75 per cent test is met, the group is entitled to look both backwards and forwards in time. For instance, the 12 months chosen in respect of a particular day, may be that day plus the previous 364 days, or that day plus the following 364 days, or any other combination of consecutive 365 days that it chooses. If the group needs to look forward in time in order to meet the test, it would need to be in possession of reliable information indicating that the test will be met. The burden of proof rests with the taxpayer. In the event that the test is not met on a prospective basis, it is hoped that the CIR would remove the unregistered company from the group prospectively rather than making retrospective adjustments and imposing penalties.

**Example:**

On 1 October 20X1, two of the four companies in the group are GST registered. As not all of the companies in the group are registered, it will not qualify for GST group registration under the first limb of the test. However, over the past 12 months 75 per cent of the group’s taxable supplies are made to persons outside the group. Accordingly, the group qualifies for GST group registration under the second limb of the test. On 2 October 20X1, there is a major supply of taxable supplies within the group, and the group’s taxable supplies over the past 12 months to persons outside the group falls below 75 per cent. At this point the group does not qualify for group registration on the factual situation to date. However, the company is able to project that over the next 12 months (ie by 2 October 20X2) it will meet the 75 per cent threshold. Accordingly, it remains GST group registered.

The following changes can be made to the group, on application to Inland Revenue by the representative member:

(a) Eligible companies can be added to or removed from the group;

(b) The representative member can be changed;

(c) The group registration can be cancelled.

If a member of the group ceases to be eligible to be a member of the group because it no longer meets the requirements of s IC 3, that company or the representative member must notify Inland Revenue in writing within 21 days. Inland Revenue will then remove that company from the group registration. Even if such a notice is not received, Inland Revenue will terminate a company’s membership of a group if Inland Revenue is aware that the company is no longer eligible.

Any notice served by Inland Revenue on the representative member is considered to have been served on all members of the group.

The effects of group registration are as follows:

(a) All taxable activities are considered to be carried on by the representative member, not by the individual members. The representative member is effectively treated as the registered person for the whole group.

(b) All members of the group must have the same taxable period and use the same accounting basis.

(c) Intra-group supplies of goods and services are not subject to GST.

(d) Any taxable supplies (other than intra-group supplies) made to or by a group member are considered to be made to or by the representative member.

(e) Any non-taxable supplies made by a group member are considered to be made by the representative member.

(f) If any goods and services acquired or produced by a group member are used by the representative member for a purpose other than making taxable supplies, the adjustment required under s 21(1) must be made by the representative member.
(g) If any goods and services acquired or produced on or after 1 October 1986 by a group member for a purpose other than making taxable supplies are subsequently used by the representative member for the purpose of making taxable supplies, the adjustment required under s 21(5) must be made by the representative member.

(h) Any input tax paid by a group member is considered to be paid by the representative member.

(i) The requirement to furnish returns applies only to the representative member, not to the individual group members.

(j) All group members remain jointly and severally liable for any GST payable by the representative member. This means that a company in the group could be liable for a GST liability arising in another company in the group if, for example, that other company went into receivership. This is an important consideration when deciding whether or not to apply for group registration.

(k) Group members are responsible for issuing their own tax invoices, keeping the records required under s 75, and complying with the registration provisions.

The GST effects of grouping, other than items (b), (h), (i), (j) and (k), are disregarded for the purposes of the reverse charge mechanism in relation to imported services [see 580.101].

(2) Other entities

Group registration is also available to entities other than companies in some circumstances. A group of registered persons may apply for group registration if any one of the following conditions are met:

(a) One of them controls each of the others;

(b) One person (whether registered or not) controls all of them;

(c) Two or more persons carrying on a taxable activity in partnership control all of them.

The main test to satisfy is one of common control. The test of common control is met if more than 50 per cent of the voting powers or profit sharing rights are held between those wanting to group or by one person having control of all of them.

Example:

The AB Trust is the majority partner in the partnership “AB Trust and C” as well as being the majority partner in the partnership “AB Trust and D’. The AB Trust could group with either or both of the two partnerships.

The CIR’s views on when a trust may group with other entities for GST purposes is contained in TIB vol 16:6 (July 2004) at 32-34.

Once the persons are registered as a group, the same rules as set out above for group registration of companies (with references to “companies” being read as references to “group members”) apply.

580.87 Partnerships, joint ventures, trusts, and other unincorporated bodies [s 57]

An unincorporated body includes, but is not limited to, a partnership, a joint venture and the trustees of a trust [see TES 5 (June 2003) 65]. The following rules apply to unincorporated bodies that are registered for GST:

(a) The members of the unincorporated body (for example the partners, joint venturers, or trustees) may not be separately registered for the taxable activity carried on by the unincorporated body.

(b) Any supply made in the course of the taxable activity is deemed to be supplied by the unincorporated body, not by any member of that body.

(c) Any supply made to any member acting in the capacity as a member and in the course of the taxable activity of the unincorporated body, is deemed to be supplied to that body and not to any member.

(d) The registration must be in the name of the unincorporated body, or in the name of the trust (if the unincorporated body is a trustee).
(e) Any change in the membership of an unincorporated body has no effect on that body’s registration, etc.

(f) All members of the unincorporated body are jointly and severally liable for all GST payable by that body for the period during which each one of them was a member. This is the case even where a person has since ceased to be a member. On a member’s death, the member’s estate is severally liable for any unpaid GST of the body. For these purposes, a member of a partnership or joint venture, or the trustees of a trust, do not cease to be members of the unincorporated body until Inland Revenue is notified in writing.

(g) A notice served under the GSTA to the unincorporated body by its registered name is deemed to be served on that body and on all its members.

(h) All members of the unincorporated body are jointly and severally liable to do anything required to be done by the body for GST purposes, such as the filing of a GST return.

(i) If the unincorporated body is not a partnership, a joint venture, or the trustees of a trust, the liability to do anything required to be done by the body for GST purposes falls jointly and severally on the body’s office holders. The primary responsibility falls on the body’s president, chairman, treasurer, or secretary. If these office holders fail to carry out their responsibilities, the liability falls to the committee members, or any similar office holder.

(j) A settlement on a trust is not a payment for a taxable supply: Chatham Islands Enterprise Trust v Commissioner of Inland Revenue (1999) 19 NZTC 15,075 (CA) [see 580.12].

580.88 Non-profit bodies [s 51(5)]

Branches or divisions of non-profit bodies may be separately registered if they are carrying on a taxable activity. A non-profit body is any society, association or organisation:

(a) Whose activities are not intended to profit any member of the body; and

(b) Whose rules prohibit the distribution of money or property to any member.

Non-profit bodies include:

(a) Charitable organisations (for example IHC, Red Cross, World Vision);
(b) Sports clubs (for example rugby clubs);
(c) Service organisations (for example Lions, Rotary);
(d) Religious organisations (for example churches, the Salvation Army);
(e) School boards of trustees.

A non-profit body may apply for one or more of its branches or divisions to be registered separately if they each have their own accounting system and can be separately identified by the nature of their activities or by their location. Once separately registered, a branch or division is no longer considered to be part of the parent organisation for GST purposes.

A branch or division of a non-profit body is only required to register for GST if its annual taxable supplies exceed the $60,000 threshold (formerly $40,000, before 1 April 2009). Thus if the turnover of a branch or division (which is eligible for separate registration), is less than $60,000 a year it does not have to register for GST if it does not want to, but it can voluntarily register if it is carrying on a taxable activity.

The CIR’s policy on the separate registration of branches and divisions of non-profit bodies is set out in TIB vol 5:11 (April 1994). The main points are:

(a) A branch or division is regarded as having its own accounting system if it separately records its receipts and payments, and if it produces separate financial statements.

(b) A branch or division is regarded as separately identified by the nature of its activities so long as those activities are not just incidental to the body’s main activity. Activities such as administration, fund raising, running raffles, providing refreshments and entertainment are usually incidental to the main activity of the body, and would therefore not justify separate registration.
(c) A branch or division is regarded as separately identified by its location if there is a distinct geographical siting. A branch or division does not exist simply because it is located on a separate floor of a building or in a nearby building which merely houses overflow staff or activities.

The policy statement includes the following examples.

**Example 1:**
A golf club which is a non-profit body has an expected annual turnover of $90,000. Funds are raised as follows:

<table>
<thead>
<tr>
<th>Source of Funds</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Garden fees, club hire, etc</td>
<td>$70,000</td>
</tr>
<tr>
<td>Fund raising (raffles and gaming machine)</td>
<td>$20,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$90,000</strong></td>
</tr>
</tbody>
</table>

The golf club could not register the two divisions separately. The fundraising is incidental to and associated with the principal activity of the golf club, so it cannot be separately identified by the nature of its activities or its location.

**Example 2:**
A non-profit national body carries on a taxable activity with an expected turnover of $130,000 per year. It is conducted in separate branches, each with its own accounting system. The expected turnovers for the next 12 months are:

<table>
<thead>
<tr>
<th>Region</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northern Region</td>
<td>$65,000</td>
</tr>
<tr>
<td>Eastern Region</td>
<td>$25,000</td>
</tr>
<tr>
<td>Western Region</td>
<td>$20,000</td>
</tr>
<tr>
<td>Southern Region</td>
<td>$20,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$130,000</strong></td>
</tr>
</tbody>
</table>

The national body could apply to have all of its branches treated as separate persons for GST purposes. Only the Northern Region (whose turnover is over $60,000), would have to register. The others could do so on a voluntary basis.

580.89 **Registration of a specified agent or mortgagee in possession**

[ss 46(7), 58]

When a registered person dies, goes into liquidation or receivership, or becomes bankrupt or otherwise incapacitated, that person’s taxable activity may be taken over by a personal representative, liquidator, receiver, or other agent. The person who takes over the taxable activity (the “specified agent”) is deemed to be a registered person carrying on the taxable activity of the incapacitated person for the agency period. If the specified agent has been appointed to carry on only part of the taxable activity, the provisions apply only in respect of that part of the taxable activity.

This deemed registration is automatic and not dependent on the CIR’s discretion. The incapacitated person is deemed not to be carrying on the taxable activity for the agency period. A specified agent is personally liable for any GST liabilities incurred during the agency period, but not for those incurred by the incapacitated person before the agency commenced.

A person is deemed to be a registered person carrying on a taxable activity of a incapacitated person even if he or she only acts in connection with the termination of that activity, for example selling off the assets of a business [s 6(2)].

When a mortgagee in possession of land or other property carries on a taxable activity previously carried on by the mortgagor (who is GST-registered), the CIR may deem the mortgagee to be a registered person for the period the mortgagee is in possession of the land or other property. Such registration is not automatic but dependent on the CIR’s discretion.

Any person who becomes a specified agent, or any mortgagee in possession who carries on the taxable activity of the mortgagor, must inform Inland Revenue in writing within 21 days. The notice must specify (as applicable):

(a) The date of death;
(b) The date of the liquidation, receivership, or bankruptcy;
(c) The date the mortgagee took possession of the land or other property;
(d) The nature of the incapacity and the date on which it began.

The GST registration number remains the same for a specified agent or a mortgagee in possession as for the incapacitated person or mortgagor.

No GST is payable on any of the assets of a taxable activity held at the time a person ceases to be registered if the taxable activity is subsequently carried on by a specified agent or mortgagee in possession who Inland Revenue has deemed to be a registered person [s 5(3)].

A specified agent is responsible for filing a return for the period from the date of incapacity to the end of the relevant taxable period [s 15(8)] and for all subsequent periods until the end of the agency period. In addition to accounting for GST outputs and inputs arising during the term of the agency, the specified agent is able to claim input tax credits to which the incapacitated person was entitled but failed to claim. However, the CIR is able to offset these credits against any pre-agency tax debt of the person.

The CIR’s policy on the application of the law relating to specified agents is set out in TIB vol 7:6 (December 1995) at 13-15. The policy statement includes examples.

580.95 Taxable activity [s 6]

Only persons carrying on a taxable activity may register for GST, and only supplies made in the course or furtherance of a taxable activity (taxable supplies) have GST charged on them. The meaning of “taxable activity” is therefore crucial for registration and in determining whether a person must charge GST on supplies made and can claim for GST on supplies received. Because of its importance, the issue of whether a taxable activity is being carried on has been at the centre of many GST cases, some of which are summarised below.

A “taxable activity” is any activity which meets the following conditions:
(a) The activity is carried on continuously or regularly, whether or not for pecuniary profit [see 580.96];
(b) The activity involves the supply of goods and services to another person for a consideration [see 580.98];
(c) It includes (but is not limited to) any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association or club.

The activities of public and local authorities are taxable activities.

Anything done in connection with the commencement or termination or premature ending of a taxable activity is deemed to be carried out in the course or furtherance of the taxable activity. Thus, for example, the sale of the assets of a taxable activity on its winding up would be treated as taxable supplies, and any expenses incurred in the process of winding up the activity would give rise to input tax deductions.

The following are not taxable activities:
(a) Any activity carried on by an individual essentially as a private recreational pursuit or hobby. In deciding whether or not an activity is a hobby, Inland Revenue [see TIB vol 6:14 (June 1995) at 6-8] will consider the following factors:
   (i) The reasons for conducting the activity;
   (ii) The duration of the activity;
   (iii) Regularity;
   (iv) The frequency of supply;
   (v) The businesslike nature of operations (but note that a profit motive is irrelevant);
   (vi) Structure and organisation;
   (vii) The level of financial investment;
   (viii) The time available to devote to the activity.
(b) Any activity carried on by a non-individual (for example, a club or society) which, if it were carried on by an individual, would be carried on essentially as a private recreational pursuit or hobby.

(c) Any engagement, occupation, or employment under a contract of service or as a company director. Thus the activity of working for wages, salaries, or directors’ fees, is not a taxable activity and does not attract GST. However, anyone carrying on a taxable activity who accepts any office is deemed to supply any services as office holder in the course or furtherance of that taxable activity. For example, a chartered accountant or lawyer who accepts appointment as a company director will charge GST on the supply of their services. For the CIR’s view on when directors’ fees constitute a taxable supply, see public ruling BR Pub 05/13, TIB vol 17:7 (September 2005) at 9-14.

(d) Any engagement, occupation, or employment such as:
   (i) The Governor-General, the Prime Minister, or a Member of Parliament;
   (ii) A Judge, the Solicitor-General, the Controller and Auditor-General, or an Ombudsman;
   (iii) An appointee of the Governor-General;
   (iv) A chairman or a member of a local authority or a statutory board, council, committee, or other body.

(e) Any activity to the extent it involves the making of exempt supplies [see 580.20]. For example, a bank whose only activity is the provision of financial services is not carrying on a taxable activity and therefore cannot register for GST.

In TRA Case T30 (1997) 18 NZTC 8,211, a company which sold its only significant asset (a restaurant business), but continued to look for ways to invest the sale proceeds, did not cease to carry on a taxable activity and was able to claim an input tax deduction for legal and accounting expenses incurred some 18 months to two and a half years after the restaurant was sold. The expenses were incurred as a result of a dispute between the company and the purchaser of the restaurant. The TRA stated that a taxpayer will not cease to carry on a taxable activity merely because it ceases to use its assets in one form of income-earning process. Provided the taxpayer continues to employ its assets in some activity, or has the intention to do so, it will not have ceased to carry on a taxable activity. The TRA also ruled that if the sale of the restaurant did, in fact, constitute the cessation of the taxable activity, the legal and accounting expenses were incurred [under s 6(2)] in connection with the termination of a taxable activity.

In Nelson v Commissioner of Inland Revenue (2001) 20 NZTC 17,220 (HC), the High Court addressed the issue of whether making a share of a farm available to a partnership constituted the carrying on of a taxable activity. In finding that a taxable activity was being carried on, the Court said that the absence of an express agreement to make the land available made no difference. It was the act of repetitively and habitually making the land available which constituted the taxable activity.

(1) Distinction between “taxable activity” and “business”

It is important to distinguish between the GST concept of “taxable activity” and the income tax concept of “business”. The key difference is that a business necessarily involves a profit motive on the part of the person operating it [see 130.10], whereas the profit motive is not a necessary precondition for a taxable activity. The profit motive may or may not be present in a taxable activity, but it is always (by definition) present in a business. For this reason, businesses will always be taxable activities, unless they make only exempt supplies, but not all taxable activities will be businesses, for example a charity selling goods (other than donated goods) to raise funds for its charitable work is not carrying on a business, but it is carrying on a taxable activity and will be required to register if supplies exceed $60,000 a year (formerly $40,000 before 1 April 2009). The difference between a taxable activity and a business is summarised in TIB vol 7:3 (September 1995) at 8-10.

580.96 Meaning of “continuously or regularly”

An activity is a taxable activity if, among other things, it is carried on continuously or regularly. To be taxable, the activity does not have to be carried on both continuously and regularly — an activity is a taxable activity if it is carried on continuously, or if it is carried on regularly. The terms “continuously” and “regularly” are
not defined in the legislation. However, their meaning has been clarified to some extent by a series of Court cases, the most important of which was the Court of Appeal decision in *Newman v Commissioner of Inland Revenue* (1995) 17 NZTC 12,097 (CA). The majority of cases (including *Newman*) which have considered the meaning of “continuously or regularly” to date have been concerned with whether certain types of land subdivision were taxable activities. These cases are explained in §80.97.

As a general rule, when determining whether a taxable activity exists, the words “continuously” and “regularly” can be regarded as having their ordinary meaning, for example an activity is continuous if there is no permanent cessation or significant interruption of the activity. A brief interruption, such as the business closing down for the weekend or for the Christmas break, would not mean that the activity is not carried on continuously. An activity is regular if it is repeated at fixed intervals, for example, if a person sells one car, the activity is not regular, but if the individual sells 12 cars each year this is fairly indicative of a regular activity. These concepts are expanded on in the following section on subdivisions.

It is the *activity* which must be carried on continuously or regularly, not the supply of goods and services. The supply of goods and services itself may be intermittent or irregular, but so long as the activity which generates or results in the supply being made is carried on continuously or regularly, it will still be a taxable activity (assuming the other necessary conditions are met).

In *Commissioner of Inland Revenue v Bayly* (1998) 18 NZTC 14,073 (CA) the provision by a trustee of land and livestock to a farming partnership of which the trustees were a partner was held to be a taxable activity. As a consequence, the trustees were liable to account for GST on the subsequent sale of the land to an associated family company. The Court of Appeal agreed with the reasoning of the earlier TRA decision that the trustees were conducting a taxable activity because:

- (a) They were carrying on the activity of making land available year by year for use and occupation by the farming partnership; and
- (b) The trust received consideration for the supply of land from the assumption by the farming partnership of the liability to pay rates and insurance, and from their entitlement to a share in the partnership profits.

The Court of Appeal also noted that the trustees had ongoing and recurring rights and responsibilities under the partnership deed, which pointed to an activity carried on continuously or regularly. The liability of the trustees to register for GST arose because the consideration, being non-monetary, must under s 10(2) be the open market value of the supply, which in this case exceeded the then-threshold of $30,000.

### §80.97 When a subdivision is a taxable activity

The leading case in relation to whether subdivisions are taxable activities is *Newman v Commissioner of Inland Revenue* (1995) 17 NZTC 12,097 (CA). This Court of Appeal case confirmed the principle that a subdivision involving the splitting of one section of land into two and the selling off of one of those sections (a typical private, residential subdivision), with minimal development work, is not an activity carried on continuously or regularly. McKay J stated that "it is not the supply of goods which is to be carried on continuously or regularly, but the activity which involves or is intended to involve, that supply”. A single supply, even if it necessitates the performance of a series of steps over time, cannot therefore be said to be carried on continuously or regularly. Richardson J said:

> “The activity engaged in by the appellant in relation to this land to provide the front lot for sale was, on the evidence, a straightforward subdivision. There was no development work on the property. The activity was not repeated over time either continuously or regularly. It did not involve repeated acts. Dissection of what was done into a series of sequential steps does not answer the statutory test of whether the activity was carried on continuously … almost any activity, even going shopping, could be broken down into a series of many sequential steps. But to do so risks detracting from the true inquiry which is whether the activity in question was itself carried on continuously or regularly by the taxpayer.”

The Court of Appeal agreed with the earlier decision in *Tout v Cook* (see below).
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The meaning of “continuously or regularly” in relation to land subdivisions is best understood by considering some of the Court cases which have dealt with this issue:

(a) In **Tout v Cook** (1991) 13 NZTC 8,053 (HC) a residential property was subdivided into two sections. One of the sections was sold, the other was retained as a residence by the vendor. The Court held that such a “one-off” property development cannot be regarded as being a continuous or regular activity as envisaged by s 6(1)(a).

(b) In **TRA Case P54** (1992) 14 NZTC 4,379, the sale of land by the trustees of a family trust was held to be neither a one-off nor a non-continuous business activity. The trust was in the business of subdividing and selling land, the trustees were at all material times registered for GST, and the subdivision and sale of part of a block was in the furtherance of their taxable activity.

(c) In **TRA Case S57** (1996) 17 NZTC 7,368, the taxpayers purchased a residential subdivision in 1984 consisting of 16 sections. They sold 12 of the sections before the introduction of GST on 1 October 1985, and retained the remaining four sections. From the outset, the taxpayers had intended to keep back four of the sections to carry out a rest home development at some future time. Subsequently, the taxpayers changed their plan to develop a rest home on the site and proceeded to dispose of the land. The four sections were sold in 1988 and 1989. The Authority held that the taxable activity of selling land had ceased before 1 October 1986 and the taxpayers were therefore not liable for GST on the sale of the sections.

(d) **TRA Case S70** (1996) 17 NZTC 7,431 concerned the subdivision of 5.7 hectares of land into five sections by a husband and wife who previously had occupied the property. This was held to constitute a taxable activity despite the fact that it was the taxpayers’ first and only venture of that type. The Authority regarded the activity as having been carried on “continuously” because it involved the subdivision and sale of multiple sections.

(e) In **Wakelin v Commissioner of Inland Revenue** (1997) 18 NZTC 13,182 (HC), the subdivision of an area of land of 2.4 hectares into six residential sections and their subsequent sale, over a period of approximately nine years, was held to be a taxable activity and therefore liable for GST. The decision turned on the meaning of “continuously or regularly” in the definition of taxable activity. Paterson J expressed the view that while a one-off subdivision involving the supply of one section could not be regarded as an activity carried on continuously or regularly (per **Newman**), a one-off subdivision involving the supply of several sections could. The subdivision in question involved extensive and ongoing work over a period of time with the ultimate aim of selling five sections. The time span was irrelevant. See also **TRA Case T40** (1997) 18 NZTC 8,267 and **TRA Case T62** (1998) 18 NZTC 8,468.

(f) In **TRA Case T60** (1998) 18 NZTC 8,449, the subdivision of a 202-hectare farm into six lifestyle blocks and the sale of those blocks was held to be a taxable activity. There was continuous activity of subdivisional work to achieve sales or supplies carried on over a period of more than two years in an uninterrupted sequence. In reaching its decision, the Authority relied on the principles in **Newman** and **Wakelin**.

(g) In **TRA Case V15** (2002) 20 NZTC 10,182, the taxpayer company had held 52 hectares of land at a beach resort since 1972. Various lots had been subdivided off over time, so that by the time the taxpayer registered for GST in 1986, only 23 hectares remained in that block. The taxpayer had claimed all expenditure relating to the land for both GST and income tax purposes. Part of the land was used free-of-charge by two unregistered subsidiaries for business purposes. However, the majority of the land was used for private recreational purposes by the taxpayer’s shareholders. Following financial difficulties, the taxpayer subdivided the land to provide better security to its lender. In 1996 the taxpayer sold two lots and part of a third lot of land to a developer. The CIR contended that the land was sold in the course or furtherance of a taxable activity. The TRA held that the land in question was not part of the taxpayer’s taxable activity, but was held as a private asset that was mixed with business assets by way of a “streamlined” accounting system. Therefore the
taxpayer was not liable for GST on the sale. Judge Barber held that the taxpayer should not have claimed all of the expenses relating to the land and all of the costs of subdivision.

(1) CIR's policy
Following the Court of Appeal decision in Newman, the CIR issued a policy statement on the meaning of taxable activity in the context of subdivisions [see TIB vol 7:2 (August 1995) at 10-13]. The principal features of the policy are as follows:

(a) A subdivision of land into two allotments, involving no development work, will not by itself amount to a taxable activity.

(b) In other circumstances, whether or not the activity is “continuous” and amounts to a taxable activity will depend on all the facts of the particular activity. The following factors are relevant in determining the existence of a taxable activity:

(i) The scale of the subdivision;
(ii) The level of development work;
(iii) The number of sales of subdivided land;
(iv) The time and effort involved;
(v) The level of financial investment;
(vi) The commerciality of the transaction.

The greater the number of allotments created and sold, the more extensive the development work, the more time and effort involved and the higher the financial commitment to the project, the more likely that there is a taxable activity. Note that the above list of factors is not exhaustive. No particular factor determines the existence of a taxable activity. The activity as a whole must be examined to see whether or not there is a taxable activity.

(c) The one-off sale of other private assets (eg a car) will not in isolation constitute a taxable activity. This is the result even if the process of sale involves a number of steps.

(d) The process of constructing and selling a commercial building is a continuous activity which falls within the definition of “taxable activity”. This is because the transaction involves substantial development work, financial investment, and time and effort.

(e) If a person carries out the process of subdivision on a regular or repeated basis, a taxable activity will exist. This is the result even if each individual subdivision is not a taxable activity in its own right.

(f) If a person who subdivides land on which a residence is located is carrying on a taxable activity, only the newly-subdivided allotments form part of that person’s taxable activity. The allotment containing the original home is separate from the taxable activity of subdivision and sale. If the person later sells the residential home (and curtilage), that sale is not made in the course or furtherance of the taxable activity of subdivision. GST will not apply, provided the residential home (and curtilage) do not form part of the assets of another taxable activity carried out by that person.

580.98 Meaning of “consideration” [s 2]
An activity is a taxable activity only if it involves the supply of goods and services to another person for a consideration. Section 2 states:

“‘Consideration’, in relation to the supply of goods and services to any person, includes any payment made or any act of forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person; but does not include any payment made by any person as an unconditional gift to any non-profit body.”

The key elements of this definition are:

(a) Consideration can be either a payment or an act of forbearance. The Courts have indicated that “payment” has a very wide meaning and can include payment in non-monetary form or by offset of
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debts. For example, in Trustee, Executors and Agency Co New Zealand Ltd v Commissioner of Inland Revenue (1997) 18 NZTC 13,076 (HC), the High Court held that the payment of rates and accounting fees by the lessee on behalf of the lessor was part of the consideration for the supply of land. An example of an act of forbearance would be a mortgagor surrendering the right to take possession of a property following default in payment by the mortgagor; or the forgiveness of a debt.

(b) A payment does not have to be voluntary in order for it to constitute consideration.

(c) The payment must be made in respect of, in response to or for the inducement of a supply. In other words, there must be a connection between the making of the payment and the supply of goods and services. The payment must be made for the supply.

(d) The consideration does not have to be provided by the person receiving the supply. If goods and services are supplied to one person, but payment for them is made by another person, the payment still amounts to consideration.

(e) A payment made to a non-profit body as an unconditional gift is not consideration for a supply. The donor must receive nothing in return for the donation, and there must be no conditions attached to the making of the gift. The meaning of “non-profit body” is explained in 580.88.

In Taupo Ika Nui Body Corporate v Commissioner of Inland Revenue (1997) 18 NZTC 13,147 (HC), the supply of goods and services by a body corporate to its owners was held not to be a supply for consideration and so did not amount to a taxable activity. The goods and services in question were supplied by independent contractors, not by the body corporate itself. The body corporate merely collected the money supplied by the owners and passed it on to the independent contractors. It did not obtain anything for its own benefit.

The CIR considers the apportionment of local authority rates on the sale and purchase of real property to be part of the consideration for the single supply of the property. The GST treatment of rates apportionment will therefore be the same as the other consideration for the property [see public ruling BR Pub 10/10, 10/11, 10/12, and 10/13 TIB vol 22:10 (November 2010) at 3-16].

Payments made to a state school or state integrated school for the provision of education of a child are not consideration, and therefore not subject to GST, provided that the child is a NZ citizen or NZ resident. This is because there is a statutory entitlement for the child to receive a free education. If other services, not integral to the supply of education, are supplied on condition that a payment is made for the services, the payment is considered and GST applies [see public ruling BR Pub 09/01, TIB vol 21:3 (May 2009) at 4-14].

Grants made by Infrastructure Auckland are not deemed to be consideration for a supply of goods or services. Recipients of those grants are not required to account for GST on the receipt of the grant, provided that certain conditions are met. [see product ruling BR Prd 04/03, TIB vol 16:3 (April 2004) at 17-22].

580.100 Imports [ss 3A, 12, 60]

Goods other than fine metal imported into New Zealand are subject to GST, which is collected by the Customs Department under the Customs and Excise Act 1996 as if it were customs duty. GST is imposed at 15 per cent (12.5 per cent prior to 1 October 2010) on the total value of imported goods including:

(a) The customs value for duty purposes;
(b) The amount of customs duty and any taxes imposed other than GST;
(c) The insurance and freight costs in bringing the goods to New Zealand (if not already included in the customs value).

“Fine metal” is defined in 580.26.

Under s 12(4)(b), goods re-imported by the same person who exported them are exempted from duty and GST if, at the time of export, those goods were not zero-rated or, if exported before 1 October 1986, they would not have been zero-rated if exported after that date. In other words, if the goods were zero-rated when originally exported, GST will be charged at 15 per cent (12.5 per cent prior to 1 October 2010) when the goods are re-imported [see TIB vol 5:13 (June 1994) at 14].
Provided that the agent and the principal agree, and the principal is non-resident and is outside New Zealand, the supply of goods in New Zealand is treated as made by the agent. This means that the agent is liable for output tax but able to claim input tax in respect of the taxable supplies made by the agent. When goods are imported for a taxable activity but cannot be used for that purpose, GST paid at the border can be recovered.

If goods are imported into New Zealand for the purpose of making taxable supplies by a registered person who accounts for GST on an invoice basis, a claim for an input tax deduction may be supported by one of the following documents:

(a) The New Zealand Customs Service Electronic Entry document;
(b) A Customs Import Entry form;
(c) A Deferred Payment of Duty statement.

See public ruling BR Pub 06/03 in TIB vol 18:6 (July 2006) at 5-8. This ruling applies indefinitely.

If goods are brought into New Zealand for less than 12 months they are treated as temporary imports. A deposit equal to the sum of the GST and duty may be payable to the Customs Department on the value of the goods imported. The deposit is refunded if the goods are removed from New Zealand within the 12-month period following their importation.

Some circumstances in which a non-resident can claim GST paid to the Customs Department as an input tax deduction are shown in the following examples from TIB vol 12:12 (December 2000 1992) at 12.

Example 1:
A non-resident art gallery decides to exhibit artwork in New Zealand and arranges this through a New Zealand agent, who is also authorised to sell the artwork. The gallery does not intend to establish itself in New Zealand and does not want to incur the costs associated with returning GST.

Provided that the agent is registered for GST and resident in New Zealand, and the art gallery and the agent agree, s 60(7) treats the agent as the supplier of the artwork in New Zealand. This means the agent will be able to claim an input tax credit for any GST paid to bring the artwork into New Zealand and will be required to pay GST on any sales.

Example 2:
An individual in New Zealand orders goods from an overseas supplier advertised through a catalogue. The order is received, along with 50 others, and is processed. The ordered goods are bulk-consigned and sent to New Zealand. A third-party handler in New Zealand receives the goods and breaks down the import into the constituent orders and posts the goods to the individuals who ordered them. The handler is registered for GST and charges the offshore supplier for the service.

The handler does not have proprietary rights to the goods but merely facilitates their delivery in New Zealand. Unless the handler acquires the goods, it will not be able to claim an input tax credit if it pays GST to uplift the goods from Customs. This is appropriate because the handler does not supply the goods in New Zealand. Although it is arguable that the GST levied at the border is incurred when applying the goods for the purpose of making taxable supplies to the offshore supplier, the goods are incidental to the services provided and cannot be said to be applied for the principal purpose of making taxable supplies.

Section 12(1A) exempts from the imposition of GST on imports those goods intended solely for the use of an organisation, visiting force, expedition, or other body approved by the chief executive of the New Zealand Customs Service that may be established or temporarily based in New Zealand under an agreement or arrangement between the New Zealand Government and the government of another country or the United Nations or other international organisation. An exemption is also granted where the goods are intended solely for the use of a person temporarily resident in New Zealand for the purpose of serving as a member of any approved organisation, visiting force, expedition, or other body.

**580.101 Imported services — reverse charge mechanism** [ss 5B, 8(4B), 8(4C), 9(2)(a)(iii), 24B, 25AA, 55(7B), 56B, 84B; s DB 2]

Historically, imported services have not been subject to GST. This has created a distortion in favour of imported services compared with domestically supplied services. A reverse charge mechanism counteracts this distortion. The measures apply from 1 January 2005.

From 1 April 2011, the application of the reverse charge mechanism is based on the intended and actual use of the imported service in the making of taxable supplies. Previously it was based on the type of supplies.
made by the importer’s business. Under the new test, the reverse charge mechanism applies only where the recipient of the supply either:

(a) estimates at the time of acquisition of the service that it will be used less than 95 per cent for making taxable supplies; or

(b) determines at the end of an adjustment period that less than 90 per cent of the services is actually used in the making of taxable supplies.

An “adjustment period” is the period in which an adjustment for apportioned supplies is required for assets that have a mixed use [see 580.128].

The reverse charge mechanism applies only to services that would be subject to GST if supplied in New Zealand. The zero-rating provisions of s 11A do not apply unless the services are physically received at the time and place at which the services are physically performed.

For the purpose of determining whether or not the registration threshold is exceeded, the registration options available and the requirement to return GST on the supply, the recipient of the supply is deemed to be the supplier. This means that the importation of services can cause a business that is currently under the registration threshold, or a private individual, to be required to register for GST. However, the provisions mainly apply to businesses making principally exempt supplies such as banks and other financial service providers.

The time of supply is deemed to be the end of the taxable period that includes the date that is two months after the balance date next following the completion of the services. This allows businesses that have imported management services from an offshore parent company to finalise the consideration for the services for the income year, before having to return the GST. Where there is a change of use of the services such that the use for making taxable supplies drops to below the 90 per cent threshold, the time of supply is the first day of the adjustment period in which the percentage falls below 90 per cent.

The GST output tax payable under the reverse charge mechanism is deductible for income tax purposes where the underlying services are deductible [ITA 2007, s DB 2]

Example 1:
A local retailer, who is just below the registration threshold, imports a set of computer games over the internet as a gift for his children. The $500 that the retailer pays for the games is just enough, when added to his taxable supplies, to breach the registration threshold. The retailer is required to register for GST and to remit to the CIR the GST on the deemed supply of the computer games. The amount of GST is $75 ($500 ÷ 23/20 - $500). As the computer games are not intended for use in the taxable activity, the amount cannot be claimed back as input tax. Neither is it deductible for income tax purposes.

Example 2:
Following the receipt of a substantial inheritance, Mary is planning to build her dream home. She secures the services of an English architect and an Italian interior designer to design the home. The total cost of these services is NZ$62,000. The services are performed overseas and the design plans are sent to Mary by post. As the services have been imported and the cost exceeds the registration threshold, Mary is required to register for GST and remit the deemed GST amount on the charges made for the design services.

Where the provisions apply to both the person and the supply, the recipient is required to add GST to the consideration paid for the supply and return this amount as output tax.

The associated persons valuation rules do not apply if the recipient of the supply is entitled to an income tax deduction for the supply, or would be had consideration been given for the supply. The associated persons valuation rules also do not apply where the recipient of the supply is a branch or division that is treated under the GSTA as a separate person and that branch or division would, if it was entitled to income tax deductions have been entitled to an income tax deduction for any consideration given for the supply.

If a non-resident makes a supply of services to a resident who is a member of the same group of companies, or to its New Zealand branch or division, the value of the supply is reduced by an amount that represents salary and wages paid to an employee of either the non-resident or of the group company and interest incurred by either the non-resident or the group company. This ensures that such things as management fees are treated on the same basis as internally generated services.
Where a contract for the supply of imported services is wholly or partly cancelled or varied, the recipient of the supply is required to make an adjustment to the amount of output tax paid or input tax claimed in the return for the GST period in which it becomes apparent that the amount claimed or paid was incorrect.

The GST grouping provisions deeming taxable activities carried on by a member of the group to be carried on by a representative member of the group, and deeming supplies made to and by group members to be made to or by the representative member [see 580.86] are disregarded for the purposes of the reverse charge mechanism.

Similarly, where a person carries on activities both inside and outside of New Zealand, each branch is treated as being a separate person and any activity carried on by a branch or division is treated as being carried on separately by the branch or division. A branch or division within New Zealand is treated as being resident in New Zealand. A branch or division that is outside of New Zealand is treated as being non-resident. For these purposes, a head office company is treated as a branch or division of the company.

Section 78, which relates to the GST effects of an alteration in law [see 580.170] do not apply to the introduction of the reverse charge mechanism.

Where a registered person receives a supply of services that is subject to the reverse charge mechanism, the following records are required to be maintained:

(a) The name and address of the supplier;

(b) The date on which, or the period during which, the services were received;

(c) A description of the services;

(d) The consideration for the services and the time by which payment is required; and

(e) The amount that salary, wages, or interest by which the recipient has reduced the value of the supply in accordance with ss 10(15C)(a) and 10(15C)(b).

The CIR has issued guidelines for recipients of imported services [see TIB vol 16:10 (November 2004) at 71-80].

### 580.105 Taxable periods [s 15]

Registered persons must account for GST monthly, two-monthly or six-monthly. The period for which a registered person accounts for GST is referred to as a taxable period. Registered persons select their preferred taxable period when they complete the GST registration form (GST1). A registered person can change their taxable period by applying in writing to Inland Revenue [see 580.107].

The choice of taxable periods available to a particular registered person depends principally on their turnover. The following table summarise the options.

<table>
<thead>
<tr>
<th>Category</th>
<th>Taxable periods</th>
<th>Available to</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Two months, ending on the last days of January, March, May, July, September, and November.</td>
<td>Any registered person not required to use Category D or who does not elect to use category C or D. If the registered person does not express a preference for category A or B, the CIR will allocate them to one or the other.</td>
</tr>
<tr>
<td>B</td>
<td>Two months, ending on the last days of February, April, June, August, October, and December.</td>
<td>All registered persons not required to use category D or who do not elect to use category C or D. If the registered person does not express a preference for category A or B, the CIR will allocate them to one or the other.</td>
</tr>
<tr>
<td>Category</td>
<td>Taxable periods</td>
<td>Available to</td>
</tr>
<tr>
<td>----------</td>
<td>-----------------</td>
<td>-------------</td>
</tr>
<tr>
<td>C</td>
<td>Six months, ending on the last days of any two months that are six months apart (e.g., 31 March and 30 September).</td>
<td>Optional for any registered person whose total taxable supplies in the last 12 months have not exceeded $250,000 or whose total taxable supplies are not likely to exceed $500,000 (formerly $250,000 before 1 April 2009) in the next 12 months or where the CIR exercises discretion under s 15A(1AA) (see below).</td>
</tr>
<tr>
<td>D</td>
<td>One month, ending on the last day of each month.</td>
<td>Compulsory for any registered person whose total taxable supplies in the last 12 months have exceeded $24 million or whose taxable supplies are likely to exceed $24 million in the next 12 months.</td>
</tr>
</tbody>
</table>

Persons who are provisional taxpayers are required to align their GST taxable periods with their balance date [s 15B].

A registered person who has not been allocated a taxable period by the CIR (for example because of oversight or as a result of a CIR-initiated registration) is automatically placed in category A. Most registered persons who adopt a two-month taxable period choose category A as this aligns with a 31 March balance date for income tax purposes.

If the taxable supplies made by a registered person during a 12-month period exceed the $500,000 or $24 million thresholds (for the six-month and one-month taxable periods, respectively) solely as a result of:

(a) The cessation, or substantial and permanent reduction in the size or scale of, a taxable activity carried on by the registered person; or

(b) The replacement of any plant or other capital asset used in a taxable activity carried on by the registered person,

the registered person does not cease to qualify to use six-month taxable periods and cannot be compelled to use one-month taxable periods.

Example:

A manufacturing company has a two-month taxable period and an annual turnover of $21 million. In anticipation of a lessening demand for its products, the company sells off a large portion of its factory site and machinery. As a result, taxable supplies for the last 12 months exceed $24 million. At this point the company would normally be required to adopt a one-month taxable period. However, as the higher than usual taxable supplies are due to the substantial and permanent reduction in the scale of the company’s operation, it may retain a two-month taxable period.

1. **End of period on death, liquidation, receivership, bankruptcy or amalgamation**

   When a registered person dies, goes into liquidation or receivership, becomes bankrupt, or ceases to exist on amalgamation [see 180 COMPANIES — AMALGAMATION], the last day of that person’s final taxable period is the date of death, liquidation, receivership, bankruptcy or cessation of existence, as applicable.

2. **End of period other than last day**

   Normally, the last day of a month is the end of a taxable period. However, a registered person may apply in writing to Inland Revenue to have a day other than the last day of the month as the end of its taxable period. A day other than the last day may be more convenient if, for example, a business’s monthly accounting procedures close off payments and receipts a few days before the end of the month. The day chosen must be within seven days either side of the last day of the month. An alternative end of period does not affect the due date for the filing of returns.
(3) **CIR’s discretion regarding six-month periods**

Section 15A(1AA) provides that the CIR may, on written application by a registered person who falls within any one of categories A, B, or D, direct that the registered person be placed within category C, after considering the following factors:

(a) The person’s history of filing and paying tax;
(b) The person’s record-keeping practices;
(c) Whether the person has been placed within category C before;
(d) The nature and volume of the person’s taxable supplies.

As outlined in the CIR’s standard practice statement [see TIB vol 13:12 (December 2001) at 8], the discretion will be exercised where the registered person:

(a) Has a good compliance history;
(b) Has satisfactory record keeping practices and the cost of more regular filing would be excessive; and
(c) Has a turnover that is subject to seasonal or low-volume/high-value cashflow peaks.

580.107 **Change in taxable period** [ss 15A, 15C, 15D]

The taxable period initially adopted by a registered person may cease to meet the needs of the registered person, or the registered person may cease to meet the criteria [see 580.105] for using a particular taxable period. In these circumstances, a change of taxable period may be required. A change in taxable period may be initiated by the registered person or by Inland Revenue as follows.

A registered person may apply to change:

(a) To a six-month taxable period (if annual taxable supplies are less than $500,000);
(b) To a two-month taxable period (if annual taxable supplies are under $24m);
(c) To a one-month taxable period;
(d) From a category A to a category B two-month taxable period, or vice versa (provided annual taxable supplies remain less than $24 million);
(e) The months in which their six-month taxable periods end.

Inland Revenue will automatically change a registered person’s taxable period if they cease to satisfy the necessary conditions, for example if a registered person’s taxable supplies have exceeded $24 million in the previous 12 months, and they currently use two-month taxable periods, they will be changed to one-month taxable periods. Similarly, if the taxable supplies of a registered person using six-month taxable periods have exceeded $500,000 in the previous 12 months, Inland Revenue will change the registered person’s taxable periods to two-monthly or (if requested, or if taxable supplies exceed $24 million) one-monthly. To enable this to be enforced, registered persons must advise Inland Revenue in writing within 21 days if:

(a) Having six-month taxable periods, their annual taxable supplies exceed or are likely to exceed $500,000; or
(b) Their annual taxable supplies exceed or are likely to exceed $24 million.

Any change in taxable period takes effect from the start of the next taxable period following notification by Inland Revenue. However, an earlier date may be specified with the agreement of the registered person.

**TaxNote:** Persons who are provisional taxpayers are required to align their GST taxable periods with their balance date [s 15B].

580.110 **Returns** [s 16]

All registered persons are required to furnish a GST return for each taxable period showing the amount of tax payable or refundable for that taxable period. The return must be furnished in the prescribed form (Inland Revenue form GST101).
Returns for taxable periods ending on or after 31 March 2007 are required to be filed on or before the 28th day of the month following the end of the taxable period. Returns otherwise due on 28 December are required to be furnished by the following 15th of January. Returns otherwise due on 28 April are required to be furnished by the following 7th of May.

**Example 1:**
A GST return for a taxable period ending on 31 May 20X1 must be filed (either mailed or physically delivered) on or before 28 June 20X1.

Where a person ceases to be registered part-way through a taxable period, a return must be furnished for the part-period during which they were registered. The due date for furnishing the return is the same date as would have applied had the person remained registered for the entire period.

When a person ceases to be registered, that person must file a final return on or before the 28th day of the month following the month in which registration ceased. The final return must cover the part of the last taxable period up to the date registration ceased.

**Example 2:**
Hamish, who had category A, two-month taxable periods, had his GST registration cancelled when he ceased business on 31 December 20X1. His final return will cover the period from 1 December to 31 December 20X1, and this return must be filed by 28 January 20X2.

The CIR may vary the date for the filing of returns in particular cases (for example to meet the circumstances of a non-profit body). A return purporting to be made by or on behalf of any person is deemed to have been made by that person or by that person’s authority, unless the contrary is proved [s 23(4)].

### 580.112 Special returns [ss 17, 18]

**1. Goods sold in satisfaction of debt [s 17]**

When repossessed goods sold in satisfaction of a debt are a deemed supply under s 5(2) [see 580.14], the person selling the goods (whether registered or not) must file a special GST return providing the following information:

- (a) The person’s name, address and (if registered) registration number;
- (b) The name, address and (if registered) registration number of the person whose goods were sold;
- (c) The date of sale;
- (d) The amount for which the goods were sold and the amount of GST charged; and
- (e) Any other particulars required by the CIR.

The return must be filed on or before the 28th day of the month following the month of sale, together with payment for the GST charged on the sale. The person whose goods were sold must be provided with details of the information supplied in the return, by the same due date. If November was the month in which the sale was made, the return and payment are due by 15 January following. If March was the month in which the sale was made, the return and payment are due by 7 May following.

Any tax included in the special return must not be included in the ordinary returns of the vendor or the person whose goods were sold.

**2. Other returns [s 18]**

In addition to ordinary returns and returns for goods sold in satisfaction of debt, the CIR can require any person, whether registered or not, to file any further or other returns required for GST administration. Such returns may be on that person’s own behalf, or as agent or trustee for another person.

### 580.113 Correction of minor errors [TAA, s 113A]

From 7 December 2009, a statutory basis exists in s 113A of the TAA for the correction of minor errors in the next return following the discovery of the error. The conditions that must be met are:
(a) The person has provided a return for income tax, FBT or GST, and the assessment includes one or more minor errors;
(b) The error was caused by a clear mistake, simple oversight or mistaken understanding on the person’s part; and
(c) For a single return, the total discrepancy caused by the error is $500 or less (for this purpose, income tax, FBT and GST are treated separately).

The CIR also has a standard practice of allowing the correction of minor errors which has applied since 1 July 1998 [see standard practice statement INV-490 in TIB vol 10:6 (June 1998) at 13-14, and the clarification statement in TIB vol 11:2 (February 1999) at 10].

The following summarises the standard practice statement:

If a registered person makes a mistake when preparing a GST return, they can correct the error in a subsequent GST return without penalty, provided total adjustments do not exceed:

(a) $200 GST (taxable supplies of $1,800) per return, for registered persons with an annual turnover of up to $250,000;
(b) $500 GST (taxable supplies of $4,500) per return, for registered persons with an annual turnover of $250,000 or more.

The maximum error figures of $200 and $500 apply to the return in which the error was originally made, not to the return in which the error is corrected. Therefore, they do not limit the value of errors that can be corrected in a later return. Errors in different return periods cannot be averaged to fit within the maximum figures.

The registered person must keep a written record of:

(a) The return period in which the error occurred;
(b) The amount of GST involved;
(c) The nature of the error; and
(d) The return period in which the error was corrected.

If the amount of the corrections exceeds the limits shown above, the registered person must correct the error by following the disputes resolution process. To do this, the registered person must prepare a notice of proposed adjustment [see 260.20] and send it to Inland Revenue within two months of filing the GST return in which the error occurred. Errors in excess of the limits may result in the registered person incurring late payment or shortfall penalties, and use of money interest.

It should be noted that there are two major differences between the standard practice statement and the statutory provision. These are:

(a) The standard practice statement allows correction of a minor GST error in any subsequent return, whereas the statutory provision allows the correction to occur only in the return immediately following the return in which the error was made; and
(b) The standard practice statement allows the correction of errors of up to $200 GST (taxable supplies of $1,800) per return, for registered persons with an annual turnover of up to $250,000 and $500 GST (taxable supplies of $4,500) per return, for registered persons with an annual turnover of $250,000 or more. The statutory basis allows the correction of errors of up to $500, irrespective of the turnover of the registered person.

580.115 Accounting basis [ss 19, 19A, 19B, 19C, 19D, 20(3)]

There are three methods by which a registered person can account for GST:

(a) Invoice basis;
(b) Payments basis;
(c) Hybrid basis.
Unless a registered person requests otherwise, they will be required to use the invoice basis. Any registered person can apply to Inland Revenue to use the hybrid basis — there are no restrictions on its use. The payments basis can only be used by:

(a) Registered persons whose taxable supplies during the previous 12 months have not exceeded $2 million;
(b) Registered persons whose taxable supplies during the next 12 months are not likely to exceed $2 million;
(c) Local authorities listed in an Order in Council and non-profit bodies [see 580.88]; and
(d) Registered persons for whom the nature, volume and value of taxable supplies and the nature of the accounting system used make it appropriate.

The $2 million threshold relates to the GST-exclusive value of the taxable supplies. The equivalent GST-inclusive amount, based on the 15 per cent GST rate, is $2,300,000 [see TIB vol 18:5 (June 2006) at 3].

Registered persons using the payments basis are required to account on the invoice basis for any supply of goods and services for a consideration of $225,000 or more unless settlement is required within one year. The CIR has the power to aggregate supplies where of the opinion that they have deliberately been broken down so as to avoid the $225,000 threshold. This requirement does not apply to a non-profit body provided that it determines at the time of supply, and on the basis of reasonable information, that the recipient of the supply is not registered and either:

(a) Does not intend to use the goods or services for making taxable supplies; or
(b) Intends to use them for making taxable supplies but not before they have been paid for in full.

If a registered person ceases to meet the criteria for using the payments basis, Inland Revenue will direct the registered person to use the invoice basis or, if requested by the registered person, the hybrid basis. A registered person who accounts for GST on a payments basis does not cease to meet the criteria for using the payments basis if their annual taxable supplies exceed $2 million solely as a result of:

(a) The cessation of, or any substantial and permanent reduction in, the size or scale of any taxable activity carried on by the person; or
(b) The replacement of any plant or other capital asset used in any taxable activity by the person.

The difference between the three methods of accounting for GST is in the timing of when the registered person must account for GST on taxable supplies made (output tax) and taxable supplies received (input tax). The following table summarises when output tax and input tax must be accounted for under each accounting basis.

<table>
<thead>
<tr>
<th>Accounting basis</th>
<th>Output tax</th>
<th>Input tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invoice</td>
<td>Earliest taxable period in which an invoice is issued or any payment is received.</td>
<td>Earliest taxable period in which an invoice is issued or any payment is made.</td>
</tr>
<tr>
<td>Payments</td>
<td>Taxable period in which payment is received.</td>
<td>Taxable period in which payment is made.</td>
</tr>
<tr>
<td>Hybrid</td>
<td>Earliest taxable period in which an invoice is issued or any payment is received.</td>
<td>Taxable period in which payment is made.</td>
</tr>
</tbody>
</table>

Except for low value supplies, a registered person must hold a tax invoice before they can claim an input tax deduction — this applies no matter which accounting basis is used [see 580.140].

A registered person may change the basis on which they account for GST by applying in writing to Inland Revenue provided, in the case of the payments basis, they meet the criteria set out above. Any change in accounting basis takes effect from the start of the next taxable period following the taxable period during which Inland Revenue confirmed the change.

When a registered person changes the basis on which they account for GST, an adjustment is required because of the difference in the way debtors and creditors are accounted for under each method [see 580.126].
580.120 Calculation of GST payable [s 20]
The amount of GST payable by or refundable to a registered person for a taxable period is the total amount of output tax (tax on supplies made) for the period less the total amount of input tax (tax on supplies received) for the period. If the result is positive, GST is payable. If the result is negative, the registered person is entitled to a refund of GST. In calculating the total amount of output tax and input tax for a period, certain adjustments are required [see 580.125].

A deduction for input tax cannot be made unless the registered person holds a tax invoice, a debit note or a credit note for the supply. However, an input deduction can be claimed in a subsequent taxable period once a tax invoice, or debit or credit note, is obtained. No tax invoice is required for low value supplies (consideration less than $50), non-taxable supplies of secondhand goods, or where, in special circumstances, the CIR has exempted the registered person from the invoice requirements [see 580.140].

If a registered person has not deducted input tax from output tax in the taxable period in which it arose (for example, due to oversight or error), the input tax can be deducted from output tax in any subsequent taxable period. With effect from return periods beginning on or after 1 April 2005, the ability to claim input deductions in later return periods has been curtailed to some degree. From that date, there is a further requirement that one or more of the following apply:

(a) The claim is made within two years of either the date on which payment for the supply was made or the date on which a tax invoice for the supply was issued;
(b) The failure to make the deduction in an earlier return period was due to:
   (i) An inability of the registered person to obtain a tax invoice;
   (ii) A dispute over the amount payable for the supply;
   (iii) A mistaken belief of the registered person that the supply was not a taxable supply; or
   (iv) A clear mistake or oversight of the registered person.

580.122 Output tax [s 2]
Output tax is the GST charged by a registered person on the taxable supplies made by that person. The total output tax for a taxable period is therefore the total GST charged on all taxable supplies made by the registered person during the period, including any output adjustments required [see 580.126]. The amount of output tax relating to a particular taxable period will depend on the accounting basis used by the registered person.

580.123 Input tax [ss 2, 3A, 20, 24, 60B]
Input tax is the GST charged on the taxable supplies received by a registered person. The total input tax for a taxable period is therefore the total GST charged on all taxable supplies received by the registered person during the period, including any input adjustments required [see 580.127]. The amount of input tax relating to a particular taxable period will depend on the accounting basis used by the registered person.

The amount of input tax claimable by a registered person acquiring a good or service for the purposes of making taxable supplies is determined by the definition of “input tax” in s 3A:

(a) If the goods or services were supplied by a registered person in the course of carrying on a taxable activity, the amount of input tax claimable by the purchaser is three twenty-thirds of the consideration paid.
(b) Where the goods have been entered for home consumption under the Customs and Excise Act 1996, the amount claimable is the tax levied under s 12(1) of the GSTA.
(c) Where the goods are secondhand goods and were acquired from a non-registered person, either where the two parties are not associated persons, or where the two parties are associated persons and the acquisition occurred prior to 10 October 2000, the amount claimable is the lower of:
   (i) One-ninth of the purchase price;
   (ii) One-ninth of the open market value.
However, where the secondhand goods are to be used in making supplies that are zero-rated under the business-to-business financial services provisions of s 11A(1)(q) and (r), no claim is available if the goods previously have been owned by the registered person or an associated person of the registered person. This limitation applies from 1 January 2005.

(d) Where the goods are secondhand goods and were acquired from a non-registered person, where the two parties are associated persons, and the acquisition occurred on or after 10 October 2000 but before 1 October 2010, the amount claimable is the lowest of:

(i) The GST component (if any) of the original cost to the supplier;
(ii) One-ninth of the purchase price;
(iii) One-ninth of the open market value.

This means, for instance, that if the supplier originally acquired the goods before the introduction of GST on 1 October 1986, no secondhand goods deduction will be claimable.

(e) Where the goods are secondhand goods and were acquired from a non-registered person, where the two parties are associated persons, and the acquisition occurred on or after 1 October 2010, the amount claimable is the lowest of:

(i) The GST component (if any) of the original cost to the supplier;
(ii) Three twenty-thirds of the purchase price;
(iii) Three twenty-thirds of the open market value.

This means, for instance, that if the supplier originally acquired the goods before the introduction of GST on 1 October 1986, no secondhand goods deduction will be claimable.

(f) Where the goods are secondhand goods and were acquired from a non-registered person who held the goods on deregistration, and where the two parties are associated persons, and the acquisition occurred on or after 10 October 2000 but before 1 October 2010, the amount claimable is the lowest of:

(i) The amount of output tax paid by the supplier on deregistration;
(ii) One-ninth of the purchase price;
(iii) One-ninth of the open market value.

(g) Where the goods are secondhand goods and were acquired from a non-registered person who held the goods on deregistration, and where the two parties are associated persons, and the acquisition occurred on or after 1 October 2010, the amount claimable is the lowest of:

(i) The amount of output tax paid by the supplier on deregistration;
(ii) Three twenty-thirds of the purchase price;
(iii) Three twenty-thirds of the open market value.

(h) If the supplier is a non-resident who has previously supplied the same goods to a registered person for home consumption, no input tax can be claimed irrespective of the supply date.

An input tax deduction can only be claimed if the goods and services were acquired for the principal purpose of making taxable supplies.

Fishing quota is not “goods”. Therefore, a secondhand goods input tax claim is unable to be made in respect of fishing quota acquired from a non-registered person. This was the conclusion reached in public ruling BR Pub 09/04, which applies for the period 13 November 2006 to 30 June 2014. The same conclusion is reached in public ruling BR Pub 09/05 in respect of coastal permits and certificates of compliance [see TIB vol 21:6 (August 2009) at 20].

An input tax deduction can be claimed for the GST on any goods and services purchased for the purpose of determining the registered person’s income tax or GST liability [see 580.124].

Non-profit bodies are able to claim input tax on all goods and services acquired other than those acquired for the principal purpose of making exempt supplies. This provision (which applies from 17 October 2002),
allows charities and other non-profit bodies to claim input tax on goods and services acquired for the purpose of, for example, collecting donations.

A GST-registered person who pays for the full cost of installing power lines to a farm property may claim an input tax deduction for the full amount of the installation cost of the power lines. In calculating the private use adjustment required under s 21(1), the taxpayer need only be concerned with the power used in the residence as well as its ongoing supply charges. The taxpayer does not need to include the installation costs in the calculation. However, when building the farm residence, the cost of connecting it to the established power supply is a private expense for which no input tax deduction may be claimed [see TIB vol 7:2 (August 1995) at 35-36].

The circumstances under which a sports club can claim an input tax deduction in relation to competition prizes is explained in TIB vol 13:5 (May 2001) at 52-53.

Where a purchaser nominates another person (a nominee) to be the recipient of the goods and services, special rules apply [s 60B]. The GST treatment depends on whether both the contractual purchaser and the nominee are both registered or not registered or whether one is registered and the other is not.

Where both have the same GST registration status, the treatment is dependent on which party actually pays for the goods or services. If the contractual purchaser pays for the goods and services, the supply is treated as having been made by the supplier to the contractual purchaser and the existence of the nominee is ignored. Similarly, if the nominee pays for the goods and services, the supply is treated as having been made by the supplier to the nominee and the existence of the contractual purchaser is ignored. If each party pays part of the contract price, the supply is deemed to have been made to the contractual purchaser unless the contractual purchaser and the nominee agree in writing that it be treated as having been made to the nominee. The option to agree is not available where the contractual purchaser has already claimed an input deduction in relation to the supply.

If the contractual purchaser and the nominee have different GST registration status, the supply is treated as being made by the supplier to the nominee.

Different rules apply to supplies that are of, or include, land [see 580.49].

In nominee transactions, it is likely that the tax invoice will be in the name of the contractual purchaser. This does not preclude the nominee from obtaining an input tax deduction provided that the following records are maintained [ss 20(2)(e), 24(7B)]:

- The name and address of the supplier;
- The date on which payment for the supply was made;
- A description of the goods and services; and
- The amount paid for the supply.

(1) Case law

The High Court case of Commissioner of Inland Revenue v Trustees in the Mangaheia Trust (2009) 24 NZTC 23,711 (HC) examined whether input tax was claimable on legal fees arising from litigation between trustees and beneficiaries and whether those legal services had been acquired for the principal purpose of making taxable supplies. The case was an appeal from the TRA’s decision in TRA Case Z12 (2009) 24 NZTC 14,142. In finding for the taxpayer, Gendall J concluded that there was a sufficient nexus between the services acquired and the making of taxable supplies, for the services to have been obtained for the principal purpose of making taxable supplies. His Honour further found that there is no requirement for the particular expenditures to be directly linked to the specific resulting products.

In TRA Case M106 (1990) 12 NZTC 2,674, it was held that the objector, an insurance broker, was entitled to a deduction for input tax on the supply of a vehicle so long as the vehicle was required by him for the principal purpose of making taxable supplies. At the time of acquisition, the principal purpose of the vehicle was for the making of non-taxable supplies. The turnover method of apportionment between goods supplied for taxable activities and goods supplied for non-taxable activities could be used to determine the relative gross receipts for life insurance and other insurance.
In TRA Case N1 (1991) 13 NZTC 3,001, a claim for input tax by the purchaser of a business was disallowed as the CIR considered it to be the purchase of a going concern, and therefore zero-rated. As a consequence, the purchaser claimed the input tax on the basis that it was a purchase of secondhand goods. The claim was disallowed by the TRA for reasons including:

(a) The purchaser could not prove that the vendors were not registered persons at all relevant times, which is fundamental to a claim for input tax in the purchase of secondhand goods.

(b) The grounds for objection could not be expanded. Consequently, the argument that the vendor was not a registered person could not apply.

(c) The zero-rating of the supply of the business as a going concern could not be avoided simply because the purchaser was not a registered person at the time.

In TRA Case N19 (1991) 13 NZTC 3,158, the taxpayer had bought a building comprising both tenanted residential accommodation and commercial premises for the purposes of a redevelopment project, but later abandoned the project and sold the property at a loss. It was held that input tax could be claimed by the objector on the full value of the purchase consideration, notwithstanding that, when the property was sold at auction on a GST-exclusive basis, the subsequent purchaser was able to reduce the GST through apportioning the purchase price between the residential letting accommodation and the commercial letting accommodation.

In TRA Case N22 (1991) 13 NZTC 3,187, the objector had two properties that were purchased for the principal purpose of making taxable supplies, viz property development, but while awaiting sale the properties were rented and therefore put to an exempt use. It was held that this was a subsidiary and secondary application and not a 100 per cent change in use. The principal purpose means more than 50 per cent and it was held that the objector be allowed an input tax deduction or credit to the extent of 51 per cent meantime.

In TRA Case R17 (1994) 16 NZTC 6,091, it was found that an input tax deduction is not claimable for the value of a dwelling house, grounds, and accompanying buildings when purchased with a farm property, as these constitute an exempt supply. The definition of “dwelling” could be construed to include situations when sharemilkers and staff are allowed to have the use of the farmhouse, grounds, and accompanying buildings.

In TRA Case R19 (1994) 16 NZTC 6,099, a partnership was not entitled to a GST input tax deduction on the value of subdivided farm land as the land had been purchased many years before GST was introduced.

In TRA Case S16 (1995) 17 NZTC 7,123, it was held that the objector could claim a full GST input tax deduction on a half share in premises purchased for both a business and a place of residence if it was established that the property was acquired for the principal purpose of making taxable supplies. As the objector used more than 50 per cent of the property for the business, on the balance of probability the objector’s predominant or principal use of the property was for business.

In TRA Case S56 (1996) 17 NZTC 7,361, the TRA ruled that a taxpayer who constructed a new farmhouse and garage primarily for the purpose of operating a farm homestay business, but also for use by his family, was entitled to an input tax deduction of 100 per cent of the input tax paid on the construction. However, the taxpayer was required to make a 40 per cent private use adjustment under s 21(1) in respect of the family’s use of the house and garage.

In TRA Case S61 (1996) 17 NZTC 7,387, a taxpayer who constructed a kitset house on a camping ground leased from the Department of Conservation was entitled to an input tax deduction for the GST paid on the building materials because the principal purpose in acquiring the house was to operate a camping ground business. It was a condition of the lease that the lessee/manager live on the site and provide his or her own accommodation in order to be on the site 24 hours per day.

In TRA Case S65 (1996) 17 NZTC 7,408, costs ordered against a taxpayer at a law practitioner’s disciplinary hearing did not constitute a taxable supply and the taxpayer could not therefore claim an input tax deduction.

In TRA Case S77 (1996) 17 NZTC 7,483, an out-of-court settlement in respect of a claim for negligence against a taxpayer is not a taxable supply and therefore does not entitle the taxpayer to an input tax deduction.

In TRA Case S99 (1996) 17 NZTC 7,622, a person registered for GST on a payments basis was held to have made payment for a property, and was therefore entitled to claim an input tax deduction, on the date an
irrevocable letter of credit became unconditional. The letter of credit was honoured six months after settlement, as agreed.

In *Nicholls v Commissioner of Inland Revenue* (1999) 19 NZTC 15,233 (CA), a taxpayer operating on a payments basis was unable to claim an input tax deduction for the entire GST component of the purchase price of a section of land at the time the deposit was paid. The deduction was limited to one-ninth of the deposit paid. The fact that only one invoice was issued in respect of the land purchase did not preclude the taxpayer from claiming an input deduction on payment of the balance. According to the Court of Appeal, s 20(3)(b)(i) places no limit on the number of occasions input tax may be deducted on the strength of a single tax invoice.

In *TRA Case T44* (1998) 18 NZTC 8,295, the purchase and erection of a portable home on a dairy farm as a residence for sharemilkers was held to be for the principal purpose of providing accommodation, not for making taxable supplies, and therefore no input tax deduction was available. However, the TRA assessed that 40 per cent of the use of the house was related to the farming activity, therefore a subsequent use adjustment of 40 per cent of the GST paid was available to the taxpayer under s 21(5).

In *TRA Case U30* (2000) 19 NZTC 9,286, the GST paid on legal expenses incurred in defending a criminal charge did not give rise to an input tax deduction. The TRA found that the taxpayer’s principal purpose in acquiring the legal services was to defend the criminal charges relating to an illegal business activity (cannabis cultivation), a purpose that was quite indirect to the taxable activity and was therefore too remote to be an input to that activity.

In *TRA Case W9* (2003) 21 NZTC 11,083, the taxpayer had claimed an input tax deduction in respect of a property transaction that ultimately did not proceed. The taxpayer was required to refund the amount to the CIR.

**580.124 GST incurred in determining tax liability** [s 20A]

A registered person can claim an input tax deduction for any GST incurred on goods and services acquired for:

(a) The calculation of the registered person’s taxable income for any income year;
(b) The calculation or determination of the registered person’s GST liability for any taxable period;
(c) The preparation of an objection or challenge to, or an appeal against, any determination or assessment made by the CIR in respect of the registered person’s income tax or GST liabilities; or
(d) Any contribution by the registered person towards the costs incurred by another registered person or taxpayer in relation to a matter which the first registered person has objected to, challenged, or appealed against.

No input tax deduction can made if the goods and services were acquired in relation to:

(a) A fraudulent or wilfully misleading income tax or GST return;
(b) An offence under any of the Inland Revenue Acts;
(c) An assessment of penal tax or a shortfall penalty, unless the assessment is subsequently cancelled;
(d) An objection, challenge or appeal which, in the opinion of the CIR, is inconsequential or frivolous.

Any recovery or reimbursement of costs incurred by a registered person in determining their tax liability (as set out above) is treated as a taxable supply made by the registered person and the output tax must be accounted for in the taxable period that the reimbursement was received.

**580.125 Adjustments**

Adjustments may be required to be made to input tax and output tax when calculating the amount of GST payable for a taxable period. The adjustments (other than the fringe benefit adjustment) are entered in total in boxes 9 and 13 for debit and credit adjustments respectively on the GST return form GST101. Debit adjustments result in GST payable. Credit adjustments result in a reduction in GST payable. The various adjustments are summarised below.
**TaxNote**: Special transitional rules apply where there is a statutory change to the GST rate [see 580.172].

(1) **Mixed use of goods and services**

From 1 April 2011, new apportionment rules apply to the adjustments for partial taxable or non-taxable use of assets. The new rules apply to assets acquired on or after 1 April 2011. They also apply where a person or partnership registers for GST on or after 1 April 2011 and uses acquired goods and services for making taxable supplies after the date of registration.

The rules that applied prior to 1 April 2011 continue to apply to assets acquired before 1 April 2011 with the exception that there is a limitation to the number of adjustments that need to be made where the asset is something other than land [see 580.126].

(2) **Second-hand goods [s 20(3)]**

In order for GST to be claimed on the acquisition of second-hand goods, the following conditions must be met:

(i) The goods must have been both sold in New Zealand and always situated in New Zealand, or have had GST levied on their importation; and

(ii) The supply must not be a taxable supply; and

(iii) The goods have not been supplied to another person who is the importer of the goods.

The amount claimable is usually the tax fraction of the amount paid for the goods. However, where the supply includes things other than second-hand goods, the amount claimable is limited to the lesser of the consideration and the market value of the goods.

Further restrictions apply where the goods have been acquired from an associated person:

(i) The general rule is that the amount of input tax is the least of:
   
   (a) The tax included in the original cost of the goods to the supplier;
   
   (b) The tax fraction of the purchase price paid by the recipient to the supplier; or
   
   (c) The tax fraction of the open market value of the goods.

(ii) Where the supplier has previously ceased being a registered person and, therefore, has been deemed to have disposed of the goods on cessation of registration, the amount of input tax on the later supply to the associated person is the least of:

   (a) The tax fraction of the value of the supply that was deemed to have occurred at the time of cessation of registration;
   
   (b) The tax fraction of the purchase price paid by the recipient to the supplier; or
   
   (c) The tax fraction of the open market value of the goods.

(3) **Assets kept after ceasing to be registered**

When a person ceases to be registered for GST, any goods and services forming part of the assets of the taxable activity are deemed to be supplied to that person at that time, unless the taxable activity is carried on by another registered person [see 580.12, 580.84]. Consequently an adjustment is required in the final GST return.

The amount of the adjustment is dependent on the dates on which the particular assets were acquired and the date on which deregistration takes place:

(a) Where deregistration occurs on or after 10 October 2000, where the asset is a pre-GST asset (acquired before 1 October 1986), the adjustment is three twenty-thirds of the lesser of cost or market value of the asset.

(b) Where deregistration occurs on or after 10 October 2000, where the asset is a post-GST asset (acquired on or after 1 October 1986), the adjustment is three twenty-thirds of the market value of the asset.
Goods and Services Tax

Example 1:
Hugh is a registered person who runs a consulting business from business premises that he owns. The premises are located in the Wellington CBD. In December 2010, he wins Lotto and retires, retaining the premises as a place to entertain his many new-found friends. The premises were acquired in November 1988 for a cost of $800,000 and have a current market value of $2.4 million. Hugh is liable for output tax on the market value of the property, being three twenty-thirds of $2.4 million = $313,043.47.

Example 2:
Same facts as above, but the building was acquired for $800,000 in 1980. Hugh is liable for output tax based on the original cost of the asset, being three twenty-thirds of $800,000 = $104,347.82.

(4) Change of accounting basis [s 19C]
When a registered person changes the basis on which they account for GST, an adjustment is required because of the difference in the way debtors and creditors are accounted for under each method. The adjustments required are set out below. In each case, if the adjustment is positive, the amount is GST payable (a debit adjustment); if the adjustment is negative, the amount is a reduction in GST payable (a credit adjustment). The registered person is required to provide Inland Revenue with a list of creditors and/or debtors (as applicable) as at the date of the change. These lists, and any tax payable as a result of the adjustment, must be provided to Inland Revenue by the return due date for the last taxable period before the change in accounting basis takes effect.

Change of accounting basis from:
(a) Invoice basis to payments basis: The adjustment required is the amount of GST on creditors as at the date of change less the amount of GST on debtors as at the date of change.
(b) Payments basis to invoice basis: The adjustment required is the amount of GST on debtors as at the date of change less the amount of GST on creditors as at the date of change.
(c) Hybrid basis to invoice basis: The adjustment required is zero less the amount of GST on creditors as at the date of change. In other words, the adjustment is a refund of GST payable on creditors as at the date of change.
(d) Hybrid basis to payments basis: The adjustment required is zero less the amount of GST on debtors as at the date of change. In other words, the adjustment is a refund of GST payable on debtors as at the date of change.
(e) Invoice basis to hybrid basis: The adjustment required is the amount of GST on creditors as at the date of change, less zero. In other words, the adjustment is a payment of GST payable on creditors as at the date of change.
(f) Payments basis to hybrid basis: The adjustment required is the amount of GST on debtors as at the date of change, less zero. In other words, the adjustment is a payment of GST payable on debtors as at the date of change.

(5) Entertainment expenses [s 21(3)]
When any entertainment expenditure is not deductible because of s DD 1 of the ITA, the GST for the non-deductible amount must be included as an adjustment. The adjustment is made only once a year in the GST return which covers the period in which the taxpayer’s income tax return is due to be filed. For example, if the income tax return is due on 7 July, an adjustment is made in the GST return which covers that date. If the return is prepared by a tax practitioner who has an extension of time arrangement with Inland Revenue, the adjustment is made in the GST return which covers the date the return is actually filed. The adjustment is three twenty-thirds of the GST-exclusive amount of entertainment expenditure which is non-deductible.

The adjustment does not apply to an entertainment allowance or a reimbursing payment that is exempt income to the employee under ss CW 17, CW 17B, CW 17C and CW 18. These relate to reimbursements and allowances for expenditure that would be deductible to the employee were it not for the employment limitation, exempt relocation payments, overtime meal and sustenance allowances, and allowances for additional transport costs.
Example 3:
Hifly Ltd paid $22,500 (including GST) for the exclusive use of a corporate box at an international cricket match held in Wellington. The corporate box was used to entertain clients and generate new business. In the GST return covering the period during which the company is required to file its income tax return that includes this entertainment expenditure, Hifly Ltd needs to make a GST adjustment:

Organisations that are not liable for income tax, such as non-profit bodies, charities, and Government bodies, do not need to make this adjustment as no deduction for entertainment is being claimed.

(6) Fringe benefits [ss 21I, 23A]

Where a registered person has provided an employee with a fringe benefit, the registered person is deemed to have made a supply of goods and services in the course of a taxable activity. The value of the supply is the taxable value of the fringe benefit reduced by any contribution made by the employee towards the cost of that fringe benefit [s10(7)]. No GST adjustment is required for fringe benefits which constitute exempt or zero-rated supplies (for example low interest loans or international travel), or are provided by a registered person in the course of making exempt supplies. The adjustment is three twenty-thirds of the value of the benefits.

TaxNote: No adjustment is required where the employer cannot obtain an input tax deduction for the cost of the benefit. This may occur with such things as gift vouchers given to an employee where GST is accounted for when the vouchers are redeemed rather than when they are issued.

Example 4:
A taxpayer’s fringe benefit tax return included the following fringe benefits:

<table>
<thead>
<tr>
<th>Fringe Benefit</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor vehicles</td>
<td>$2,605</td>
</tr>
<tr>
<td>Low-interest loan</td>
<td>$425</td>
</tr>
<tr>
<td>Journal subscriptions</td>
<td>$52</td>
</tr>
<tr>
<td>Subsidy on employee’s overseas honeymoon</td>
<td>$600</td>
</tr>
</tbody>
</table>

The benefits liable for GST are the motor vehicles and the journal subscriptions. The low interest loan and the subsidy on overseas travel are excluded because they are exempt and zero-rated respectively. The GST adjustment is ($2,605 + $52) × 3 / 23 = $2,657 × 3 / 23 = $346.56. The $346.56 is deductible from the taxpayer’s income.

Where the granting of the fringe benefit arises in the course of the taxpayer producing exempt supplies, for example a company car provided to a life assurance salesperson, a deemed supply does not occur. No GST is payable on the granting of the motor vehicle fringe benefit to the salesperson.

Employers are required to pay GST on the taxable value of fringe benefits. The adjustment is made in the employer’s fringe benefit tax return for the period in which the benefit is granted.

(7) Bad debts written-off [s 26(1)]

When a registered person has made a taxable supply and accounted for the output tax on it, and later written-off all or part of the consideration as a bad debt, an input adjustment must be made for the GST content of the bad debt. The adjustment is made in the taxable period in which the debt is written-off. The adjustment cannot be made for a provision for bad debts — the debt must actually be written-off [see 90 BAD DEBTS AND BAD DEBTS RESERVES, TES 5 (June 2003) 68 and 69].

Public ruling BR Pub 05/01 [see TIB vol 17:2 (March 2005) at 5] sets out the CIR’s view of the requirements for the writing off of a bad debt for GST and income tax purposes. The ruling allows an income tax deduction under s DJ 1(a)(iii) of the ITA 1994 [now s DB 31(1)(a)], and a deduction from GST output tax under s 26(1)(c). The ruling applies from 1 April 2004 for an indefinite period.

According to the ruling, the following conditions must be met:

(a) An existing debt is owing to the taxpayer;
(b) The debt is adjudged as “bad” when a reasonably prudent commercial person would conclude that there is no reasonable likelihood that the debt will be paid; and

(c) The bad debt is “written-off” in accordance with the accounting and record keeping systems maintained by the taxpayer.

What constitutes “written-off” depends on the class of taxpayer concerned. Where the taxpayer is a large corporate or business taxpayer who maintains a computerised bad debts system, the writing off is achieved by an authorised person making the appropriate entry in that system recording the debt as written-off. Where the taxpayer is a company (other than one falling within the above class), by an executive or other responsible officer of the company with the authority to do so, the writing off is achieved by making the appropriate bookkeeping entries in the books of account of the company. For a taxpayer (other than a company) that maintains double-entry accounts, by an authorised person making the appropriate bookkeeping entries in the books of account the writing off is achieved by way of the business recording the debt as written-off. For a taxpayer who is an unincorporated sole trader or small unincorporated business which does not maintain double-entry accounts, the taxpayer can note in the bookkeeping records the amount owed by the bad debtor, that the debt has been written-off, and the date of the writing off.

**TaxNote:** Public ruling BR Pub 05/01 does not consider or rule on the tax treatment of arrangements to which the avoidance provisions in the ITA or the GSTA are applicable.

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**Example 5:**

Milly, who uses the invoice basis, sells Fred electrical goods for $375, including GST, and issues him with an invoice for this amount. Milly includes the sale in her GST return for the period ended 31 August. In March of the following year, she gives up hope of getting payment from Fred and writes off the $375 as a bad debt. In her return for the period ended 30 April, Milly includes an input adjustment of $48.91 ($375 × 3 / 23).

Where a debt is factored by a registered person accounting for GST on an invoice basis, any difference between the price received from the factor and the face value of the debt is not a bad debt for the purposes of s 26 and the registered person is not able to claim a GST deduction. If a portion of the debt is written-off before the debt is sold to a factor, a GST deduction will be claimable provided that the amount was written-off as bad according to the normal tests for the write-off of bad debts [see public ruling BR Pub 06/01 in TIB vol 18:5 (June 2006) at 26-29].

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(8) Bad debts recovered [s 26(2)]

When a registered person has claimed an input tax deduction for GST on a bad debt written-off [see 580.127], and all or part of that debt is subsequently recovered, an adjustment is required to account for the GST on the amount of the debt recovered. The adjustment is three twenty-thirds of the amount recovered.

**Example 6:**

Laurie, a used car dealer who uses the invoice basis of accounting for GST, has written-off a bad debt of $4,500 but later recovers $3,600 of this amount. Laurie must make an adjustment of $469.56 ($3,600 × 3 / 23) in the taxable period in which he recovers the $3,600.

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(9) Factored debts [s 26A]

Registered persons who account for GST on the payments basis are required to pay GST on the remaining book value of a debt when it is factored. Section 26 allows an input tax credit when a factor exercises a right of recourse and the debt becomes bad after it is returned to the assignor.

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(10) Barter transactions [s 10(2)]

When taxable supplies are provided in exchange for other goods and services, rather than for money, an adjustment is required of three twenty-thirds of the open market value (including GST) of the consideration.

**Example 7:**

Sally agrees to complete Barry’s tax return in exchange for Barry cutting the lawns around her offices every week for four weeks. Both are registered for GST. Sally would have charged $100 to complete Barry’s tax return. Barry charges $30 per week to cut lawns of a similar size to Sally’s. Sally needs to make an adjustment of $15.65 ($120 × 3 / 23) in her GST return, and Barry makes an adjustment of $13.04 ($100 × 3 / 23).
When the consideration consists partly of money and partly of goods and services, the money is included along with normal
sales receipts to calculate output tax, and the open market value of the goods and services is used to calculate an adjustment.
When the buyer and seller have agreed in advance on a monetary value for the supply, and goods and services are provided in
exchange for the supply (for example a trade-in), the value of the supply is the agreed monetary amount. This is treated as a
normal supply.

(11) Exported second-hand goods [s 10(4)]
When a registered person exports goods which were purchased by that person second-hand, and for which
an “imputed” input tax deduction has been claimed [see 580.123 ], an adjustment is required of three twenty-
thirds of the cost price of the second-hand goods.

Example 8:
Oscar, an antique dealer, purchased antiques from a private individual for $3,780. At the time of purchase, he claimed an input
tax deduction of $493.04 ($3,780 × 3 / 23). Later, he exported the antiques to a buyer in the UK after obtaining all the necessary
export documentation. The sale price to the UK buyer was $6,426. Oscar must make an adjustment of $493.04 in the taxable
period during which he exported the antiques. Prior to 1 October 2010, the amount of the initial claim and the required adjustment
was $420 ($3,780 / 9).

TaxNote: The adjustment is based on the cost of the goods, not the export price.

(12) Insurance payments received [s 5(13)]
When a registered person receives an indemnity payment under an insurance policy for a loss incurred in a
taxable activity, the payment constitutes a taxable supply and the registered person must account for the GST
on the supply [see 580.12 ]. An adjustment is not required when the payment is for loss of earnings. The
adjustment is three twenty-thirds of the amount of the indemnity payment.

Example 9:
Marvo Manufacturing Ltd received an insurance payment of $124,000 following fire damage to one of its factories. The company
needs to make an adjustment of $16,173.91 ($124,000 × 3 / 23) in its GST return for the period in which the payment is received.

(13) GST paid to or invoiced by Customs Department [s 12]
The Customs Department is responsible for collecting GST when:
(a) Goods are imported into New Zealand; and
(b) New Zealand manufactured goods are removed by a purchaser from a bonded warehouse (eg liquor
or tobacco). GST is charged on the amount of the excise duty.

When GST is paid to the Customs Department, a registered person is able to claim an input tax credit in the
same way as for any other taxable supply received, however the amount is required to be shown separately
as an adjustment. The supporting Customs documents must be held before the adjustment can be made
[see 580.100].

Example 10:
Murray imports a specialised woodworking machine from the US for use in his joinery business. The GST charged by the
Customs Department on the landed value of the machine is $3,500. Murray received the Customs documentation on 15 June. In
his taxable period covering 15 June, Murray claims an input credit of $3,500. This is included as an input adjustment in his GST
return.

Each of the adjustments is explained in more detail in the following paragraphs.

580.126 Apportionment rules for mixed or concurrent use of goods and
services [ss 3A, 20, 21, 21B, 21D, 21F, 21G, 21H]
From 1 April 2011, new apportionment rules apply to the adjustments for partial taxable or non-taxable use
of assets. The new rules apply to assets acquired on or after 1 April 2011. The rules that applied prior to
1 April 2011 continue to apply to assets acquired before 1 April 2011 with the exception that there is a
limitation to the number of adjustments that need to be made where the asset is something other than land.
Goods and Services Tax

(1) **Assets acquired before 1 April 2011 [s 21H]**

Adjustments must continue to be made under the “old” rules for assets acquired before 1 April 2011. However, the time period for which these adjustments must continue to be made is limited and no adjustment is either required or permitted on or after the following dates:

- 1 April 2011 for goods or services (other than land) whose market value or book value on that date is $5,000 or less;
- 1 April 2013 for goods or services (other than land) whose market value or book value on that date is $5,001 to $10,000;
- 1 April 2016 for goods or services (other than land) whose market value or book value on that date is more than $10,000.

There is no time limit for adjustments under the old rules in respect of land.

For details of the calculation of adjustments under the “old” rules see Staples Tax Guide 2011 edition.

The new rules applying to assets acquired on or after 1 April 2011 (see below) also apply to assets acquired before that date where the person first registers for GST on or after that date and uses those existing assets in making taxable supplies.

(2) **Assets acquired on or after 1 April 2011**

(a) **Background**

The new rules apportion input tax deductions according to the anticipated and actual use of the goods and services, rather than whether they will be used principally for making taxable supplies or principally for private or exempt purposes.

At the time of acquisition, the registered person is required to make an adjustment based on the intended percentage of use of the item. For example, if it was anticipated that the asset would be used 60 per cent for the purpose of making taxable supplies, the initial GST claim would be based on the 60 per cent estimate. If it was anticipated that the asset would be used 30 per cent for the purpose of making taxable supplies, the initial GST claim would be based on the 30 per cent estimate.

In subsequent years, further adjustments may be required where the actual percentage use proves to be different from the anticipated percentage use. There are limits on the number of further adjustments that need to be made. These limits are based on the asset’s value or estimated useful life.

When goods or services that have been subject to the apportionment rules are sold, a “washup” calculation is required to be made to ensure that the correct amount of GST has been claimed over the period during which the item was owned.

The rules apply to goods and services, not just fixed assets. Therefore they will need to be considered for some costs other than the acquisition cost of a fixed asset. For example, while ongoing running costs such as fuel for a vehicle would tend to be consumed in a very short period and be subject to apportionment based on the use of the vehicle in a single GST period, costs relating to such things as extended warranties or fleet vehicle maintenance contracts may need to be considered over a longer period.

These rules apply for GST purposes, not income tax purposes. Apportionment of expenses for income tax purposes continues to be subject to existing rules for deductibility under the ITA.

**TaxNote:** In the course of preparing this material, a number of drafting issues have been identified. These have been raised with Inland Revenue who is understood to be recommending legislative corrections. The following material is based on the policy as advised by Inland Revenue and the drafting errors have been ignored.

(b) **Apportionment at time of acquisition [s 20(3C), 20(3D), 20(3G), 20(3H), 20(3J)]**

At the time at which goods and services are acquired, the purchaser can deduct input tax based on the extent to which the goods or services are intended to be used for, or available to be used for, making taxable supplies [s 20(3C)].
The estimate is required to be based on an apportionment method which will provide a fair and reasonable result [s 20 (3G)]. This can be based on existing records, previous experience, business plans, or other data and may differ depending on the type of asset and the uses to which it is to be put. Once the estimate has been made, it is required to be expressed as a percentage. This percentage is then applied to the amount of GST paid on acquisition of the goods and services to calculate the amount that may be claimed [s 20(3H)].

There is a de minimis provision to provide relief from the requirement to apportion input tax for assets which are to be used for providing both exempt and taxable supplies (not private use). No adjustment is required where the person has reasonable grounds for believing that their exempt supplies in the first adjustment period will be no more than the lesser of $90,000 or 5 per cent of the consideration for all taxable and exempt supplies [s 20(3D)].

Example:
Mary purchases a new car which, based on the logbook for her existing car, will be used 60 per cent for business use and 40 per cent for private use. The cost of the car is $46,000 of which the GST content is $6,000 ($46,000 x 3/23). The amount of input tax that Mary can claim is $6,000 x 60% = $3,600. Had Mary estimated that the percentage of business use would be 20 per cent, she would be entitled to claim $6,000 x 20% = $1,200.

Where the acquisition of the goods and services was treated as a zero-rated supply, an adjustment is required to be made [s 20(3J)]. This applies to transactions involving the supply of land which are required to be zero-rated under certain circumstances [see 580.49]. The first step is to ascertain the nominal amount of GST that would have been included in the acquisition cost had it not been a zero-rated supply. Then the percentage of intended use that will relate to making taxable supplies, and the amount of the adjustment, need to be calculated (see above).

Example:
Finance Ltd commences business and acquires a building for $3 million which it intends to use as its business premises. As both the seller and Finance Ltd are registered for GST and Finance Ltd intended to use the building for making taxable supplies, the transaction was required to be zero-rated. Finance Ltd estimates from its business plan that 80 per cent of its supplies will be exempt supplies and the other 20 per cent will be taxable supplies. As this exceeds the de minimis of $90,000 or five per cent (see above) an adjustment is required to be made. The first step is for Finance Ltd to calculate the nominal amount of GST on acquisition. This is the acquisition price multiplied by the GST rate which is $3,000,000 x 15% = $450,000. This amount is then multiplied by the percentage of intended use in making non-taxable (exempt) supplies $450,000 x 80% = $360,000. Finance Ltd is required to account for output tax of $360,000.

(c) Subsequent adjustments [s 21G, 21D, 21(2)]

Subsequent adjustments will need to be made only if the actual use of the goods and services differs from what was initially anticipated. These adjustments (if any) are made at the end of “adjustment periods”. The first “adjustment period” starts on the date of acquisition and ends on whichever of the following two dates the person chooses:

(a) The first balance date that falls after the date of acquisition; or

(b) The first balance date that falls at least twelve months after the date of acquisition.

Example:
John has a 31 March balance date. He acquires a new car on 1 November 20X1. He makes the initial claim in the GST return for the period in which he acquires the car. This is based on the anticipated business use of the car. John needs to determine whether any further adjustment is required in the first and subsequent adjustment periods. The first adjustment period will end on either 31 March 20X2 (the first balance date following acquisition of the car) or 31 March 20X3 (the first balance date that falls at least twelve months from the date of acquisition of the car).

The maximum number of adjustment periods that apply to any particular asset depend on either the GST-exclusive cost of the asset or, at the person’s option, the estimated useful life of the asset as specified in the CIR’s tax depreciation rate determinations.

The maximum number of adjustment periods for which adjustments are required to be made for assets other than land are:

GST exclusive cost of asset Maximum number of adjustment periods

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$5,001 to $10,000  
$10,001 to $500,000  
$500,001 or more  

There is no limit to the number of adjustment periods for land.

No subsequent change in use adjustments are required where the GST exclusive cost of the asset is $5,000 or less.

The de minimis threshold for the initial adjustment for assets used in making both taxable and exempt supplies (see above) applies also in respect of subsequent adjustments.

Example:
Catherine purchases a bench saw for $4,600. The saw is for use in her building business but she will also use it when doing work around her house. GST adjustments need to be made. Catherine estimates that the use of the saw will be 95 per cent for her business and five per cent for private purposes. In the return for the GST period in which she acquired the saw, Catherine makes an adjustment of five per cent of the GST component of the acquisition cost, being 5% x 600 = $30. The GST exclusive cost of the saw was $4,000 ($4,600 - $600). As this is less than $5,001 Catherine is not required to make any adjustments for the saw in future adjustment periods.

Where none of the exemptions applies, adjustments will need to be made in subsequent adjustment periods only if the change in the percentage of use for making taxable supplies exceeds 10 percentage points.

In the first adjustment period following acquisition of the asset, the comparison is made between the “percentage intended use” for making taxable supplies at the time of acquisition and the “percentage actual use” for making taxable supplies during the adjustment period.

In subsequent adjustment periods, the comparison is made between the “previous actual use” for making taxable supplies and the “percentage actual use” for making taxable supplies.

If the difference between the two figures is the same or differs by less than 10 percentage points, no adjustment needs to be made unless the value of the adjustment exceeds $1,000. If the difference is 10 percentage points or more, an adjustment is required irrespective of the amount.

If an adjustment is required, the amount is calculated using the amount of GST included in the acquisition of the asset. If the asset is land and the acquisition was zero-rated, the amount used is the nominal amount of GST for the acquisition (see above).

If an adjustment is required to be made, the formula is:

\[
\text{full input tax deduction} \times \text{percentage difference}
\]

The number of months in the adjustment period is also taken into account.

Example:
Jason has a 31 March balance date. On 1 October he acquires a new car for $46,000. He anticipates that it will be used 90 per cent for making taxable supplies and 10 per cent for private purposes. At the time of acquisition he claims GST of 90% x $6,000 = $5,400.

As the car cost $40,000 exclusive of GST, the number of adjustment periods is five. He chooses to have his first adjustment period end on the first balance date following acquisition.

First adjustment period
In the first adjustment period, Jason’s business use of the car is 89 per cent. The difference between “percentage intended use” of 90 per cent and the “percentage actual use” is one percentage point. An adjustment will need to be made only if it exceeds $1,000. The calculation is $6,000 x 1% = $60. Jason does not need to make an adjustment.

Second adjustment period
During the second adjustment period, Jason decides to take a holiday and tours the South Island with his family. As a result of this trip, his percentage business use of the car for the twelve months to his next balance date is only 51 per cent. The first step is to identify the “percentage actual use”. This is based on six months at 89 per cent and 12 months at 51 per cent. The calculation is:

\[
(6/18 \times 89\%) + (12/18 \times 51\%) = 29.66\% + 33.99\% = 63.65\%
\]
As Jason was not required to make an adjustment in his first adjustment period, this figure is compared with his “percentage intended use” which was 90 per cent. The difference is 26.35 percentage points (90 - 63.65). As this is 10 percentage points or more, an adjustment is required to be made. The calculation is $6,000 x 26.35% = $1,581 GST to pay.

Third adjustment period

At the end of the third adjustment period, Jason’s logbook indicates that the percentage business use of the car for the year has been 91 per cent. The calculation that needs to be made compares the “percentage actual use” with the “previous actual use”. The calculation based on the 30 months since acquisition of the car is:

\[ (6/30 \times 89\%) + (12/30 \times 51\%) + (12/30 \times 91\%) = 17.8\% + 20.4\% + 36.4\% = 74.6\% \]

As the use of the vehicle has changed by 10 percentage points or more (74.6 - 63.65 = 10.95), an adjustment is required to be made. The calculation is: 10.95% x $6,000 = $657 GST claimable.

Fourth adjustment period

At the end of the fourth adjustment period, Jason’s logbook indicates that the percentage business use of the car for the year has been 87%. The calculation based on the 42 months since acquisition of the car is:

\[ (6/42 \times 89\%) + (12/42 \times 51\%) + (12/42 \times 91\%) + (12/42 \times 87\%) = 12.71\% + 14.57\% + 25.99\% + 24.85\% = 78.12\% \]

As the difference between the “percentage actual use” and the “previous actual use” is only 3.52 per cent and the adjustment would be only $211.20, no adjustment is required to be made.

Fifth adjustment period

Jason again takes a holiday and this time tours the North Island. His percentage business use of the car for the twelve months to his next balance date is 53 per cent. The calculation based on the 54 months since acquisition of the car is:

\[ (6/54 \times 89\%) + (12/54 \times 51\%) + (12/54 \times 91\%) + (12/54 \times 87\%) + (12/54 \times 53\%) = 9.88\% + 11.33\% + 20.22\% + 24.85\% + 11.77\% = 78.05\% \]

This is compared with the “previous actual use” for the adjustment period in which an adjustment was last made (the third adjustment period). The change is 3.45 percentage points (78.05 - 74.60). As any adjustment would be only $207, no adjustment is required to be made.

As five adjustment periods have now passed, no more adjustments are made until the car is disposed of (see below).

(d) “Washup” adjustment on disposal [s 21F]

When an asset has been subject to apportionment, a final adjustment is required to be made when the item is disposed of in the course of carrying on a taxable activity. The formula for the adjustment is:

\[ \text{tax fraction} \times \text{consideration} \times \frac{[1 - \text{actual deduction}]}{\text{full input tax deduction}} \]

Where:

“Tax fraction” is the tax fraction for the applicable GST rate. For the 15 per cent rate the tax fraction is three twenty-thirds.

“Consideration” is the amount of consideration received or deemed to be received for the disposal.

“Actual deduction” is the amount already claimed, taking into account all adjustments made to the date of disposal.

The amount calculated under the formula, when added to the total of any deductions already claimed, must not exceed the GST component (or nominal component) of the original acquisition cost.

Example:

Continuing with the above example of Jason’s car, assume that Jason continued to use the car in his business for three more years and then sold it for $23,000 inclusive of GST.

Jason has not claimed the full amount of the GST component of the original acquisition of the car. The full amount was $6,000 and the total of Jason’s claims at the time of acquisition and in the five adjustment periods is $5,390.76 ($5,400 - $1581 + $657).

Applying the formula:

\[ 3/23 \times 23,000 \times [1 - \$5,390.76/\$6,000.00] = \$2,999.99 \times (1 - 0.89) = \$2,999.99 \times 0.11 = \$329.99 \]

When this is added to the amount already claimed by Jason, the total is $5,720.75. As this does not exceed the full amount of GST on acquisition ($6,000), Jason is able to claim the full $329.99 as an input tax (credit) adjustment.

A different formula applies to sales of land that have been zero-rated under the land provisions [see 580.49]. The formula is:

\[ \text{tax fraction} \times \text{consideration} \times (1 - \text{previous use}) \]

where:

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“Tax fraction” is the tax fraction for the applicable GST rate. For the 15 per cent rate the tax fraction is three twenty-thirds. However, if the disposal is itself zero-rated the tax fraction is 15 per cent, rather than three twenty-thirds.

“Consideration” is the amount of consideration received or treated as received for the supply.

“Previous use” is the percentage intended use or previous actual use in the period prior to the period in which the disposal occurs.

(e) **Transitional rule for dwellings [s 21HB]**

As a result of the changes to the definitions of dwelling and commercial dwelling, supplies that were previously exempt supplies are now taxable supplies. Examples include some hostels and homestays. Provided the person is GST registered, a one-off adjustment is able to be made. The person is treated as having acquired the dwelling on 1 April 2011 at the original cost of the supply. This means that the amount of the adjustment is calculated using the original cost multiplied by the tax fraction as at that date, being three-twenty-thirds. The amount of the adjustment is then reduced by any amount of input tax claimed under the old apportionment rules.

(f) **Concurrent use of land [s 21E]**

Concurrent use occurs where an asset is used for both GST-taxable and GST-non-taxable purposes at the same time. The most common example is probably where a land developer has a property advertised for sale (GST-taxable) and, while awaiting sale, rents the property out as a domestic rental (GST-non-taxable).

Registered persons are required to calculate the extent to which the asset is used for making taxable supplies. A formula is provided in the Act but registered persons are able to apply to the CIR for an alternative method where the formula is not workable in their particular circumstances.

The formula is:

\[
\frac{\text{Consideration for taxable supply}}{\text{Total consideration for supply}} \times 100\%
\]

Where:

“Consideration for taxable supply” is the amount derived on a disposal of the land or, if the land has not been disposed of, the market value of the land at the time of the adjustment.

“Total consideration for supply” is the sum of:

- The amount of the “consideration for taxable supply”; and
- The amount of all rental income derived from the supply of a dwelling since the land was acquired; and
- If no rental income is paid or payable in relation to the non-taxable use of the land, the market value of rental income that would have been derived from the time of acquisition of the land if rental had been charged.

If any amounts are derived from associated persons or are not arms-length amounts, market value is required to be substituted. This applies to both “consideration for taxable supply” and “total consideration for supply”.

If the market value of either of these amounts is not readily ascertainable, another method that provides a fair and reasonable estimate of market value can be used.

**Example (taken from TIB vol 23:1 (February 2011) at 38):**

Sandy, a property developer, constructed two similar residential houses, House A and House B, next to each other. The construction cost of each house is $230,000 (including GST of $30,000). Sandy intends to sell both properties on completion (a taxable use) and therefore claims a full deduction on the GST incurred on construction.

Sandy is unable to sell the property immediately on completion. Therefore, while still advertising the houses for sale, she:

- Rents out House A and receives rental income of $26,000 in the first adjustment period; and
- Moves into House B and lives there rent-free.

At the end of the first adjustment period, Sandy sells House B for $360,000.

**Adjustment at the end of the first adjustment period— House A**

Since Sandy used the house concurrently for taxable (advertising for sale) and exempt (supplying a residential dwelling) purposes, she uses the formula in s 21E(3) to identify the actual taxable use of the property in the first adjustment period.
The “consideration for taxable supply” is either the amount derived on a disposal of the land or, if the land has not been disposed of, the market value of the land at the time of the adjustment. Sandy has not disposed of House A, but ascertains that the market value of the house is approximately the same as for House B—$360,000.

The “total consideration for supply” is the amount of the “consideration for the taxable supply” ($360,000) and the amount of all rental income ($26,000) derived from the supply of the dwelling since the land was acquired—$386,000.

Therefore, Sandy’s taxable use of the house is:

$$\frac{360,000}{386,000} \times 100 = 93\%$$

Sandy has therefore deducted seven per cent more input tax than she should have and has to account for this to Inland Revenue:

$$30,000 \times 7\% = 2,100$$

Adjustment at the end of the first adjustment period—House B

Since Sandy used the house concurrently for taxable (advertising for sale) and private (residential) purposes, she has to use the formula in s 21E(3) to identify the actual taxable use of the property in the first adjustment period.

The “consideration for taxable supply” is the amount derived on a disposal of the house—$360,000.

Since Sandy did not rent out House B, but still used it for non-taxable purposes, the “total consideration for supply” is the amount of the “consideration for the taxable supply” ($360,000) and the market value of the rental income that she would have derived if she had rented out the property. Sandy estimates that she would have received $26,000 of rental income.

Therefore, Sandy’s taxable use of the house is:

$$\frac{360,000}{386,000} \times 100 = 93\%$$

Sandy has therefore deducted seven per cent more input tax than she should have and has to account for this amount to Inland Revenue:

$$30,000 \times 7\% = 2,100$$

In both cases it should be noted that Sandy may be able to recover some or all of the unclaimed input tax if she later disposes of the houses in the course of her taxable activity. (See “Washup adjustment on disposal” above).

If the land is at any time used solely for making non-taxable supplies (for example it is taken off the market and rented out on a permanent basis) an additional formula must then be applied. It is:

$$\frac{\text{Months}}{\text{Total months}} \times \text{result}$$

Where:

“Months” is the number of months in which all or part of the land is used to some extent for making taxable supplies.

“Total months” is the total number of months since acquisition.

“Result” is the result calculated under the concurrent use adjustment (see above).

**Example (taken from TIB vol 23:1 (February 2011) at 39):**

The facts are the same as in the above example. Assume that the length of the first adjustment period was 12 months.

In the second adjustment period, Sandy continues both letting out and advertising for sale House A. However, six months after the start of the second adjustment period, Sandy stops advertising House A for sale as she decides to permanently rent it out.

In the second adjustment period, she receives rental income of $30,000. The market value of House A at the time of the adjustment is still $360,000.

At the end of the second adjustment period, Sandy uses the formula in s 21E to identify the taxable use of the house. For the purposes of the second adjustment period, the “total consideration for supply” is the sum of the market value of the house and all rental income received since the land was acquired:

$$\frac{360,000}{416,000} \times 100 = 86.5\%$$

However, because the house has been used for six months solely for making non-taxable supplies, she has to apply the formula in s 21E(6):

$$\frac{18}{24} \times 86.5\% = 64.8\%$$

Sandy’s percentage actual use of House A in the second adjustment period is 64.8 per cent. The percentage actual use must be compared with the “previous actual use”, that is with the percentage actual use as determined in the most recent period in which an adjustment has been made. For Sandy, the previous actual use will be 93 per cent. Sandy has therefore deducted 28.2 per cent more input tax than she should have and has to account for this to Inland Revenue:

$$30,000 \times 28.2\% = 8,460$$
(g) Goods and services acquired before registration [ss 21B 3A(3C)]

Where a person registers for GST on or after 1 April 2011, the new apportionment rules apply to goods and services acquired before registration. This is the case whether the goods and services were originally acquired before 1 April 2011 or after that date. It is the date of registration that is important.

GST will be claimable only where it was payable at the standard rate on acquisition and where the GST exclusive cost was more than $5,000. Section 21B which allows the adjustment does not apply where the cost was $5,000 or less. A further requirement is that the person hold a tax invoice for the original acquisition or have adequate records that enable the identification of the particulars that would be in a tax invoice.

**TaxNote:** There is an error in TIB vol 23:1 (February 2011). The statement at the foot of page 41 is incorrect in that it states that the cost must have been $5,000 or less. This error has been pointed out to Inland Revenue. They have advised that a correction in a future TIB is intended.

The GST deduction claimable when the person first registers and the goods or services are first used in the making of taxable supplies is calculated under the apportionment rules. The first adjustment period starts on the date of acquisition of the goods and services and ends on the first balance date following registration and use of the goods and services in the making of taxable supplies. Subsequent adjustments are made according to the standard rules (see (3) above).

Where the goods and services have been acquired from an associated person, the total amount of GST claimable under the adjustment provisions is limited to the amount of output tax accounted for by the associated person [s 3A(3C)].

**Example:**

On 1 April 20X1, Fiona acquired a car for $46,000 inclusive of GST of $6,000. On the same day she commenced a small business which she carried on for the next two years. On 1 April 20X3, Fiona registered for GST as she had reached compulsory registration threshold.

As the cost of the car was over $5,000 and provided that Fiona has kept the tax invoice or has records that enable the identification of the details that would be on a tax invoice, she will be able to make a claim for a portion of the GST that was included in the original purchase of the car. She will make the claim on the balance date following registration. This will be 31 March 20X4, by which time she will have owned the car for three years. In each of the three years, Fiona’s logbook shows an 80 per cent use of the car.

Notwithstanding the constant level of business use of the car, Fiona has used the car for making taxable supplies for at the rate of zero per cent for the first two years (as she was not registered) and 80 per cent for the third year. The adjustment for the first adjustment period will be based on:

\[
(0\% \times 24/36) + (80\% \times 12/36) = 51.11\%
\]

This gives an input tax adjustment (credit adjustment) of $3066.60 ($6,000 x 51.11%).

As the car’s total cost was between $10,001 and $500,000, the maximum number of adjustments is five. Therefore four more adjustment periods will occur in the future if Fiona continues to own the car for that period. A “washup” adjustment will be required to be done on any future sale of the car.

580.128 Goods and services acquired before incorporation [s 22]

A company may claim an input tax deduction for the GST paid on goods and services purchased for the company prior to its incorporation if all of the following conditions are met:

(a) The company must be registered when the deduction is claimed;

(b) The goods and services must have been taxable supplies;

(c) The goods and services must have been purchased no more than six months prior to the date of incorporation;

(d) The goods and services must have been purchased for or on behalf of the company, or in connection with the incorporation of the company (for example, legal costs);

(e) The goods and services must have been purchased by a person who became a member, officer or employee of the company;
The person who purchased the goods and services must have been fully reimbursed by the company for the cost of them;

The goods and services must have been acquired for the purpose of the taxable activity to be carried on by the company;

The goods and services must not have been used for any purpose other than that taxable activity;

The supply of goods and services by the person to the company must not be:

  (i) A taxable supply; or
  (ii) A non-taxable supply of secondhand goods;

The company must hold sufficient records to support the claim for an input tax deduction.

Payment of GST [s 23]

Any GST payable for a taxable period must be paid to the CIR on or before the due date for the filing of returns [see 580.110].

The calculation of the amount of tax payable for a taxable period is explained in 580.120.

The amount showing on a return as the amount of tax payable is taken as the correct amount unless the CIR has challenged it or has issued an assessment showing a different amount.

Relief where new start grant made [s 48A]

Where a registered person has received a new start grant in respect of their taxable activity, the CIR has the power to remit, either wholly or partly, any amount of GST payable that relates to both the new start grant and the taxable activity. This includes both the GST payable in respect of the grant itself and any GST payable due to the cessation of the taxable activity, whether prematurely or not.

The same power to remit exists in respect of an associated person of the person who received the new start grant. In this case, the GST that can be remitted must relate to the person’s taxable activity (including its ending) or land on which the taxable activity was carried on (including its sale or disposal).

Example:

John farms land owned by a company. The shares in the company are owned equally by John and his wife, June. John receives a new start grant due to the effects of a flood. As John and the company are associated persons, the CIR has the power to remit GST in respect of both John and the company.

A “new start grant” is defined in s YA 1 as:

   “A grant of money that is designated by the Minister of Agriculture as a new start grant and is paid by the Government of New Zealand to a person in relation to –

   “(a) an adverse event:

   “(b) an event that is a qualifying event”

In order to qualify for the remission, the person must have furnished all GST returns required under the GSTA 1985.

Refunds of GST [ss 20(5), 45, 46]

(1) Excess tax paid [s 45]

Any GST paid by a registered person to the CIR in excess of the amount assessed for a taxable period must be refunded to that person. However, the refund will not be paid unless the registered person applies for it in writing within four years after the end of the taxable period.

If the amount of tax payable by a registered person has decreased, or the amount of tax refundable has increased, as a result of a revised assessment, the excess must be refunded to that person. The refund will not be paid unless the registered person applies for it in writing within four years after the end of the year in which the new assessment was made.
The four-year periods are increased to eight years where the overpayment of tax is due to clear mistake or simple oversight. Prior to 1 April 2005, the period was eight years in all circumstances.

(2) Return shows a refund [ss 20(5), 46]

If the total input tax for a taxable period exceeds the total output tax, the registered person is entitled to a refund. The excess must be refunded by Inland Revenue within 15 working days following the day on which the return was received by Inland Revenue. However, if the CIR is not satisfied with the return, the CIR may investigate the return and request the registered person to provide further information. The CIR must notify the registered person in writing within 15 working days following receipt of the return if the CIR intends to investigate it. Any request for information must be made to the registered person within 15 working days following receipt of the return. Any request for information subsequent to the initial request must be made within 15 working days following the date of receipt of the information previously requested.

In *Contract Pacific Ltd v Commissioner of Inland Revenue* SC114/2009, 16 November 2010, the Supreme Court addressed the question of whether the CIR was obliged by s 46 of the Goods and Services Tax Act 1985 to refund GST of $7,542,295.51 to Contract Pacific Ltd (Contract Pacific) as at 5 February 2001. Under s 46(1)(a), where an amount of GST is refundable to the taxpayer, the CIR must make the refund within 15 working days of receiving a return, unless within that time he is not satisfied with the return and requests further information about it or gives notice that he intends to investigate the circumstances of the return. Contract Pacific’s return was received by the CIR on 26 June 2000. On 10 July, within 15 working days, the CIR gave notice of intention to investigate the return. The effect of s 46(1)(b) is that, once such notice is given within the specified time, there is no obligation to refund GST until the CIR has both determined that the amount is refundable and is also satisfied that the registered person has complied with the person’s tax obligations (a conclusion to be reached on wider tax liability than may be entailed in assessing whether the GST is refundable).

In *Sea Hunter Fishing Ltd v Commissioner of Inland Revenue* (2001) 20 NZTC 17,206 (HC), Master Faire found that the request for information or the notification of an intention to further investigate the return must be received by the taxpayer within the 15 working day period. Any notice sent by post is deemed to have been received when, in the normal course of post, it would have been delivered and not, as the CIR contended, at the time at which it is posted. The finding on this point was upheld on appeal: *Commissioner of Inland Revenue v Sea Hunter Fishing Ltd* (2002) 20 NZTC 17,478 (CA).

In a further Court of Appeal decision relating to *Sea Hunter Fishing Ltd* Glazebrook J found that a notice of assessment and a payment of the input tax claimed by the taxpayer were not evidence of an agreement in writing to the taxpayer’s claim. Therefore, the CIR was not precluded from making further inquiries or issuing a reassessment which disallowed the claim: *Sea Hunter Fishing Ltd v Commissioner of Inland Revenue* (2004) 21 NZTC 18,569 (CA).

Once the CIR is satisfied with the return, the refund must be paid the next day. Use of money interest must be paid by the CIR on any amount not refunded within the time limits.

In *Almond Properties Ltd v Commissioner of Inland Revenue* (2003) 21 NZTC 18,289 (CA), the taxpayers put forward three arguments in support of their contention that the CIR was required to issue them with a GST refund. The first was that the CIR is required to apply their mind to the return and convey to them that they were not satisfied with it. The Court of Appeal held that the sending of the letter stating that they were not yet satisfied was sufficient. The second was that the CIR’s information request did not comply with the requirements of s 46. However, the Court held that a statement that the returns were to be reviewed and that further information would be required was sufficient. The third argument was that, if the CIR requests further information and that information is supplied, the CIR must make a further information request within 15 days or pay the refund. This argument was dismissed as “misconceived”.

If the registered person has not filed a return for any taxable period, the CIR can withhold payment of the refund and any use of money interest until the returns are filed. The CIR must notify the registered person in writing within 15 working days following the receipt of the return if the CIR intends to withhold a refund.
(3) **Power to offset [s 46(6)]**

If a registered person has any unpaid tax to pay (GST or income tax), the CIR may offset the amount otherwise refundable (including excess tax paid and any use of money interest) against that unpaid tax. Where a person is an agent for an incapacitated person [see 580.89], and the agent is entitled to a deduction for supplies made before the commencement of the agency period, the CIR may deduct that amount in payment of GST or income tax that is payable by the incapacitated person.

### 580.140 Tax invoices [s 24]

A registered person who makes a taxable supply to another registered person must, at the request of the recipient, provide the recipient with a tax invoice within 28 days (unless the supply is for $50 or less). Under normal circumstances it is not necessary to make such a request as most businesses routinely issue tax invoices for all taxable supplies they make. A registered person may not issue more than one tax invoice for the same supply, but a duplicate can be supplied at the request of the recipient if it is clearly marked “copy only”.

A tax invoice is an invoice containing the information detailed below. The type of invoice which must be provided by a supplier depends on the value of the taxable supply.

In calculating the amount of GST on a tax invoice, any amount less than or equal to half a cent is disregarded, and any amount of more than half a cent is rounded up to a whole cent.

An input tax deduction may not be claimed by a registered person who is an individual on an invoice made out to a partnership: *TRA Case M132 (1990) 12 NZTC 2,859.*

It is extremely important that a registered person obtains a tax invoice (or a debit or credit note) for all taxable supplies they receive in excess of $50, because an input tax deduction cannot be claimed unless the registered person holds one. The importance of retaining tax invoices is highlighted by the following cases:

In *Bennett v Commissioner of Inland Revenue* (1996) 17 NZTC 12,676 (HC), the taxpayer was assessed for additional GST of more than $30,000 following an Inland Revenue audit which resulted in expenditure being disallowed due to the absence of supporting documentation. As a result of failing to pay the outstanding GST, the taxpayer was adjudicated bankrupt.

In *TRA Case T15* (1997) 18 NZTC 8,090 a company taxpayer, whose major shareholder and managing director refused to provide Inland Revenue inspectors with tax invoices following a GST audit, was reassessed after having had all its input deduction claims for a period in excess of five years disallowed. Inland Revenue took action under s 400 of the ITA 1976 to recover the outstanding amount from the director’s bank account. The director eventually provided Inland Revenue with the necessary information, and the subsequent audit revealed that all except two of the 32 returns reviewed were in fact correct. The director could have saved himself considerable time and stress if he had simply provided Inland Revenue with the invoices in the first place.

In *Lanauze v King* (2001) 20 NZTC 17,360 (HC), Young J found that an “approved form of transfer of individual term quota or transferable term quota” did not qualify as an invoice for GST purposes.

1. **Consideration for supply of $50 or less**

If a taxable supply is for an amount of $50 or less, the supplier is not required to provide the recipient with a tax invoice and the recipient does not require a tax invoice to support an input tax deduction. However, the recipient must keep a record of the purchase, and Inland Revenue recommends that, as a minimum, the purchaser record the date, description of the supply, cost and name of the supplier.

2. **Consideration for supply of $50 to $1,000**

If a taxable supply (other than a zero-rated supply) is for an amount of more than $50 but no more than $1,000, a simplified form of tax invoice may be used which must contain the following details:

(a) The words “tax invoice” in a prominent place;
(b) The name and registration number of the supplier;
(c) The date the tax invoice is issued;
(d) A description of the goods and services supplied;
(e) The consideration for the supply and a statement that it includes GST.

If the supply is zero-rated, a full tax invoice must be provided (as for supplies in excess of $1,000).

(3) Consideration for supply of more than $1,000

If a taxable supply is for an amount of more than $1,000, or if the supply is zero-rated, a full tax invoice must be provided and must contain the following details:
(a) The words “tax invoice” in a prominent place;
(b) The name and registration number of the supplier;
(c) The name and address of the recipient;
(d) The date the tax invoice is issued;
(e) A description of the goods and services supplied;
(f) The quantity or volume of the goods and services supplied;
(g) Either:
   (i) Separate figures for the consideration excluding GST, the total GST charged, and the GST-inclusive consideration; or
   (ii) The GST-inclusive consideration and a statement that it includes GST.

(4) Modified tax invoices

In certain circumstances, Inland Revenue will approve the issuing of tax invoices without some of the details normally required, or may even permit a registered person to make taxable supplies without issuing tax invoices at all. Inland Revenue will only do this if it is satisfied that sufficient records are available to enable it to establish all the details required for each supply, and if it would be impractical to require that a tax invoice be issued. An approved modified tax invoice must contain the words “modified tax invoice — IRD approved” in a prominent place.

580.141 Shared tax invoices [s 24BA]

In some circumstances, two or more suppliers can issue a single tax invoice for goods and services. This occurs where the two or more suppliers either:
(a) Are part of the same group of companies for GST purposes; or
(b) Have statutory obligations which make it practical to use the shared invoice option.

An example of where shared tax invoices might prove to be useful is for local body rates where a single tax invoice could suffice for both Regional council and City Council rates in respect of a property.

Shared invoices must contain the following information:
(a) The words “tax invoice” in a prominent place;
(b) The name and registration number of the principal supplier;
(c) The name and address of the recipient;
(d) The date the tax invoice is issued;
(e) A description of the goods and services supplied; and
(f) Either:
   (i) Separate figures for the consideration excluding GST, the total GST charged, and the GST-inclusive consideration; or
   (ii) The GST-inclusive consideration and a statement that it includes GST.

Where the conditions are met, the single tax invoice is treated as having been provided by each of the suppliers.
The “principal supplier”, being either the supplier responsible for issuing the invoice or the representative member of a group of companies, is required to maintain sufficient records to enable the name, address, and registration number (if any) of the actual supplier to be ascertained.

580.142 Buyer-created tax invoices [ss 24(2), (9)]

In some industries, it is more convenient or logical for the amount charged for a supply to be determined by the recipient rather than by the supplier, and for the recipient to issue a tax invoice for the supply. Tax invoices may be created by the recipient of goods and services, provided the following conditions are met:

(a) Inland Revenue has approved their use;
(b) The supplier and the recipient are both registered persons;
(c) The supplier and the recipient have agreed that only the recipient will issue a tax invoice;
(d) The supplier and the recipient both keep a copy of the tax invoice;
(e) The words “buyer created tax invoice — IRD approved” are prominently displayed on the tax invoice;
(f) All the other requirements for a tax invoice are met. If the tax invoice covers taxable supplies by both the supplier and the recipient (for example, in the case of a farmer supplying livestock to a freezing works) the registration numbers of both parties must be shown on the tax invoice.

Inland Revenue may withdraw approval for the issue of buyer-created tax invoices if the conditions for that approval have not been complied with.

580.143 Credit and debit notes [s 25]

If the amount of GST charged for a taxable supply is altered after a tax invoice has been issued, the supplier must issue the recipient with a debit or credit note, as applicable. The amount charged for a supply could change because:

(a) The supply has been cancelled;
(b) The goods and services (or part thereof) have been returned;
(c) The nature of the supply has been fundamentally varied;
(d) The price has been altered.

The CIR has determined that it is not necessary to issue a credit or debit note where the consideration for a supply is altered due to the removal from circulation of the five cent coin. This is because the effects of rounding will be shown on the docket issued by the supplier. It is the adjusted amount of consideration that should be included in the person’s GST return [see TIB vol 18:9 (October 2006) at 12].

If the sale is cancelled, the goods and services returned or the amount charged is reduced, the supplier will issue a credit note. If the amount charged is increased, the supplier will issue a debit note.

It is normal business practice to issue credit and debit notes. To meet the GST requirements, a credit or debit note must contain the following information:

(a) The words “credit note” or “debit note”, as appropriate, prominently displayed;
(b) The name and registration number of the supplier;
(c) The name and address of the recipient;
(d) The date the note was issued;
(e) The difference between the amount charged on the original tax invoice and the correct amount;
(f) A brief explanation of the circumstances giving rise to the issuing of the credit or debit note.

In the case of a cancelled sale, the credit note will be for the same amount as that charged on the tax invoice. When a credit or debit note is issued, the supplier and recipient will need to make the following adjustments in their GST returns in the period the note is issued.

Credit note:

(a) The supplier will reduce its taxable supplies made by the amount shown on the credit note;
(b) The recipient will reduce its taxable supplies received by the amount shown on the credit note.

Debit note:
(a) The supplier will increase its taxable supplies made by the amount shown on the debit note;
(b) The recipient will increase its taxable supplies received by the amount shown on the debit note.

580.144 Electronically transmitted invoices [s 25A]

Tax invoices, and debit and credit notes, may be supplied in electronic format because the definition of “document” in s 3 of the Tax Administration Act includes all information, all devices on which information is held, and all devices associated with such a device. This is wide enough to include any electronic data, computer programmes, computer tapes and computer discs. To facilitate the electronic transfer of tax invoices, or debit or credit notes, Inland Revenue may approve the use of symbols, abbreviations or other notations to represent any particulars required to be contained in these documents. Such approvals may be general or may apply only to a specific registered person or class of registered persons [see TES 5 (June 2003) at 73].

580.145 Secondhand goods [s 24(7)]

When a registered person purchases secondhand goods, and that supply is a non-taxable supply (eg from an unregistered person), the supplier is unable to issue a tax invoice. The purchaser is able to claim an input tax deduction for the “imputed” GST on the supply [see 580.123], but to do so the purchaser must keep a record of the following details of the supply:
(a) The name and address of the supplier;
(b) The date the secondhand goods were acquired;
(c) A description of the goods supplied;
(d) The quantity or volume of the goods supplied;
(e) The consideration for the supply.

In order for a secondhand goods input tax claim to be available, the following conditions must be met:
(a) There must be a supply by way of sale;
(b) The supply must be made to a registered person;
(c) The supply must not be a taxable supply;
(d) The supply must be of secondhand goods that are situated in New Zealand at the time of supply;
(e) The goods must be acquired for the purpose of making taxable supplies;
(f) Payment must have been made.


TaxNote: For the avoidance of doubt, taxpayers may wish to enter into a cheque swap when dealing with associated parties.

The word “goods” means all kinds of real or personal property, but excludes choses in action. A “chose in action” is a thing in respect of which a man has no actual possession or enjoyment but merely a right enforceable by action: Re Marshall (dec’d) [1965] NZLR 851 (CA). Therefore knowledge is a chose in action, but the right to use knowledge evidenced in a contract is not: TRA Case V9 (2001) 20 NZTC 10,101.

If the amount paid is less than $50, these details do not have to be kept but a record of the purchase should still be kept.

The term “secondhand goods” is not defined for GST purposes, but the following are specifically excluded [s 2]:
(a) Fine metal;
(b) Goods to the extent they are made from any fine metal;
Goods and Services Tax

(c) Livestock.

Because the term “secondhand goods” is not defined, it must take its ordinary meaning, that is, goods that have been previously used by someone else, and goods that are not new or not obtained from the original source. Examples of goods that the CIR considers are not secondhand are:

(a) All animals, including progeny — livestock includes domestic animals generally and any animals kept or dealt in for profit;
(b) Primary produce from farming (eg wool, meat, milk);
(c) Any goods that have been manufactured that are being supplied for the first time;
(d) Trading stock consisting of any of the above.


(1) Forestry rights

A forestry right (s 2 of the Forestry Rights Registration Act 1983) is a right granted by the owner or lessee of land to a person to establish, maintain and harvest a crop of trees on that land. The right may also include ancillary rights of access and of constructing roads, bridges and buildings, and may make provision for the payment of charges, royalties and so on to the grantor of the right.

In public ruling BR Pub 07/01 (an indefinite period from 1 October 2006), the CIR has ruled that a forestry right is a secondhand good for which an input tax deduction can be claimed if the following conditions are met:

(a) A forestry right is sold to a registered person;
(b) The sale is not a taxable supply;
(c) The right is situated in New Zealand at the time of supply;
(d) The right is acquired by the registered person for the principal purpose of making taxable supplies;
(e) The right has been used by at least one previous owner for its intrinsic purpose.

The original grant of a forestry right cannot be a sale of a secondhand good — only subsequent sales of the same right can be secondhand. The transfer of ownership must be by way of sale. Transfers by way of lease or a sub-grant of the right do not qualify. The input tax deduction must be claimed in the taxable period in which payment for the right is made [s 20(3)(a)(ia)]. If the sale is by instalment, input tax deductions must be claimed in each taxable period an instalment is paid [see public ruling BR Pub 07/01, TIB vol 19:3 (April 2007) at 4].

(2) Case law

In TRA Case N16 (1991) 13 NZTC 3,142, it was held that the purchase of deer velvet from unregistered persons did not constitute the acquisition of secondhand goods.

In TRA Case P45 (1992) 14 NZTC 4,314, the purchase of half shares in a building from an estate was considered to be a purchase of secondhand goods as the vendor executors were not carrying on a taxable activity and were not required to be a GST-registered person. The objectors, as purchasers, met the criteria under s 20(3)(a)(ia) and were entitled to an input deduction on the transaction because there had been a supply of secondhand goods.

In LR McLean and Co Ltd v Commissioner of Inland Revenue (1994) 16 NZTC 11,211 (CA), wool was held not to be secondhand goods for GST purposes.

In Union Corporate Services Ltd v Commissioner of Inland Revenue (1997) 18 NZTC 13,151 (HC), a subsidiary of the appellant company (not the company itself) was held to have acquired the beneficial ownership of a vessel purchased in the Isle of Man, even though the appellant company had paid for the vessel and the true nature of the arrangement had not been fully reflected in contemporaneous accounting entries. The most compelling piece of evidence was the fact that, at that time, it was unlawful to register a ship in the Isle of Man in the name of any party other than its beneficial owner. The vessel had been registered there in the name of the subsidiary company. As a result of this finding, the appellant company was entitled
to claim an input tax deduction for secondhand goods in respect of its subsequent purchase of the vessel from the subsidiary. At the time of purchase the vessel was situated in New Zealand.

In *TRA Case V9* (2001) 20 NZTC 10,101, it was found that the sale to a company by its shareholders of the exclusive right to further develop and enhance, market, license or franchise, and utilise certain business concepts was a sale of goods that were not choses in action, but was not a sale of secondhand goods.

**580.150 Assessment [ss 27-31]**

The CIR may at any time issue an assessment, or an amended assessment, of the amount of GST payable. The CIR does not have to issue an assessment for each GST return filed. The CIR must give notice of an assessment to the person liable to pay the GST, but failure to do so does not invalidate the assessment. The validity of an assessment is not affected if any of the provisions of the GSTA have not been complied with.

Assessments can be made for:

(a) Any person required to file a GST return;

(b) Any unregistered person who supplies goods and services and represents to charge GST on them;

(c) Any person whose registration has been cancelled because they have not carried on a taxable activity since they were registered. Even though the person’s registration is cancelled retrospectively, the person is still deemed to have been a registered person from their original date of registration until the date their registration was cancelled, and the person must pay any GST represented to have been charged on any supplies made during that period;

(d) Any person who breaches a tax obligation [see 1270.05]; and

(e) Any person selling goods in satisfaction of a debt, or the person whose goods are sold in satisfaction of a debt if they have supplied an incorrect written statement [s 5(2)].

The assessment can be based on the information supplied in a return and on any other information in the CIR’s possession.

The CIR must issue an assessment if a taxpayer requests in writing that a return be amended and if an assessment has not already been made. Once the assessment is made, the taxpayer is liable to pay the GST assessed unless the amount of tax is shown, on objection or challenge, to be incorrect.

A taxpayer who has made a genuine error in the preparation of a GST return (eg a calculation or transcription error), may request that the assessment for the relevant period be amended by the CIR to correct the error [see 80.22]. A small error in a GST return may be corrected in a subsequent return [see 580.113].

**TaxNote:** An assessment, once made, cannot be disputed on any grounds in any Court or proceedings except by following the challenges procedures in Part 8A of the TAA [see 260.70]. For this reason, if a person believes they have been incorrectly assessed, it is extremely important that they initiate the disputes resolution procedures by issuing Inland Revenue with a NOPA or a response notice, as applicable, within the two-month response period [see 260.20 to 260.35]. Failure to follow these procedures means that the person loses all legal rights to dispute an incorrect assessment. If in any doubt whatsoever, seek professional advice.

In respect of GST periods beginning on or after 1 April 2005, taxpayers who are required to provide a GST return are required to make an assessment of the amount of GST payable for the GST period. The assessment is made on the date on which the return is received by Inland Revenue. Where a person fails to file a GST return, or files a return with which the CIR is not satisfied, the CIR can make an assessment. The CIR is not able to amend an assessment to increase the amount of GST payable after four years following the end of the GST period in which the return was provided. However, no time limit applies where the CIR considers that the person has knowingly or fraudulently failed to disclose all of the material facts that are necessary for determining the amount of GST payable. This restriction may have little effect in practice as GST returns are normally filed without documentation to validate the figures contained in the return [ss 92B, 106(1C), 108A].
580.152  **Priority of GST owing on bankruptcy, liquidation, receivership, or mortgagee sale** [s 42]

When a person who owes GST to Inland Revenue goes into bankruptcy, liquidation or receivership, the amount of GST owing has the following ranking in relation to other debts:

<table>
<thead>
<tr>
<th>Circumstances</th>
<th>Ranking of unpaid GST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bankruptcy of an individual, or individual makes and assignment for the benefit of creditors</td>
<td>After preferential claims for wages etc, and in priority to all other claims</td>
</tr>
<tr>
<td>Company in liquidation</td>
<td>As provided for in sch 7 of the Companies Act 1993</td>
</tr>
<tr>
<td>Company in receivership</td>
<td>As provided for in sch 7 of the Companies Act 1993. See also <em>Rob Mitchell Builder Ltd (in liq) v National Bank of New Zealand Ltd</em> (2004) 21 NZTC 18,397 (CA)</td>
</tr>
<tr>
<td>Receivership of an unincorporated body, including a partnership, joint venture or trustee (as defined in s 57)</td>
<td>After preferential claims for wages etc, and in priority over any claims of debenture holders under any floating charge</td>
</tr>
</tbody>
</table>

580.153  **Attachment notices** [s 43]

If a registered person fails to pay GST that is due (including any interest, late payment penalty or shortfall penalty), Inland Revenue can recover the debt from any amount payable to the registered person by any other person. The most common examples are money deposited at a bank by the registered person, and salaries or wages owing to the registered person by an employer. The debt is recovered by issuing an attachment notice to the person (ie the bank or employer) requiring them to deduct an amount from money otherwise payable to the registered person and pay it to Inland Revenue. The notice may require the deduction to be made in one lump sum, such as from a bank account, or by a number of instalments, such as from salaries or wages. The notice may also require the deduction of daily interest until the total amount specified in the notice has been deducted.

An attachment notice cannot be issued in respect of a home layby account, a home ownership account, a farm ownership account or a fishing vessel ownership account at a bank. A bank includes a building society.

From 21 December 2010, the CIR is specifically entitled to access funds held in a joint account where the registered person is able to access those funds without the signature or other authorisation (such as a pin number) of the other account holder or holders. Note that the CIR’s ability to access funds held in a joint account does not extend to the bank account of a business partnership that files a return of income under s 33(1) of the TAA.

When an attachment notice relates to wages or salary, the minimum weekly deduction is $10. The maximum weekly deduction is the lesser of:

(a)  Ten per cent of the unpaid GST at the date of the attachment notice;

(b)  Twenty per cent of the wages or salary payable.
An attachment notice can be revoked by Inland Revenue at any time. An attachment notice must be revoked at the request of the registered person if all outstanding tax has been paid. Copies of all notices must be sent immediately to the registered person.

The person to whom an attachment notice is issued must send the registered person a statement whenever a deduction is made, showing the amount of the deduction and the reason why it was made. The person making a deduction or payment in terms of an attachment notice is indemnified. The following amounts are deemed to be held in trust for the Crown and may be recovered from the person to whom the attachment notice was issued as if it were tax payable:

(a) Any amount deducted but not yet paid to Inland Revenue;
(b) Any amount (to the extent of the amount required to be deducted) which becomes payable to the registered person but from which the required deduction has not been made.

580.154 Liability of directors and shareholders for GST of company [s 61]

Where a company has entered into an arrangement that has put it into a position where it cannot meet its GST liabilities, the tax owing, any civil penalty, and any use-of-money interest, can in some circumstances be recovered from the directors and controlling shareholders. Section HD 15 applies as if references to tax or income tax were references to GST [see 40.40].

580.160 Agents [ss 59, 60]

When an agent makes a supply for and on behalf of a principal, the supply is deemed to be made by the principal and not the agent. However, if the supply is a taxable supply and the agent is registered, the agent may issue a tax invoice or a credit or debit note for that supply [see TES 5 (June 2003) 70]. The principal may not also issue a tax invoice or a credit or debit note for the same supply.

Example 1:
A cafe proprietor, who is registered for GST, sells original paintings on behalf of two local artists. The paintings are displayed on the walls of the cafe. One of the artists is registered for GST, the other is not. When the cafe owner sells paintings for the unregistered artist, the supply is a non-taxable supply and no GST has to be charged, even though the cafe owner is registered. When the cafe owner sells paintings for the registered artist, GST must be charged on the supply. The supply is deemed to be made by the artist, and the artist must account to Inland Revenue for that GST and include the sale in the appropriate return. If the purchaser of the painting requests a tax invoice, the cafe owner (as agent) can issue a tax invoice for the supply. The artist cannot then also issue a tax invoice for the same supply.

Example 2:
An advertising agency purchases advertising time on television on behalf of its clients. As all the television companies are assumed to be registered, all supplies of advertising time will be taxable supplies. The advertising agency can request the television companies to provide tax invoices for all supplies. However, the supplies are deemed to be supplies made to the advertising agency’s clients, and not to the agency itself.

If a tax invoice or a credit or debit note has been issued by or to an agent as above, the agent must keep a record of the name, address and registration number (if any) of the principal.

The CIR’s views on whether funeral directors act as agents of their clients in respect of the supply of goods or services from third parties are set out in TIB vol 13:8 (August 2001) at 9. The article states that goods and services such as flowers, burial plots and funeral notices would normally be acquired by the funeral director at the request of their client and that the funeral director would be acting as agent for their client. Where this is the case, the goods are deemed to have been acquired by the client and the funeral director is not entitled to a GST input tax credit. Where the funeral director charges out the amount as a disbursement, no GST should be added to the amount charged. Any amount charged in excess of the cost to the funeral director would be part of the fee for the services supplied by the funeral director and would be subject to GST.
Sheriffs executing writs of sale are not obliged to account to the CIR for outstanding GST until they have paid their own expenses and sums owed to any creditors with security over the assets. They are carrying out their powers as officers of the Court and are not acting as agents for the party who obtained the writ: *Sheriff of the New Zealand High Court v Commissioner of Inland Revenue* (1996) 17 NZTC 12,599 (HC).

(1) **Non-resident principal**

When a registered person makes a taxable supply to an agent acting on behalf of a non-resident principal, the supply can be treated as if it were made to the agent and not to the principal, and therefore the agent can claim an input tax deduction, if the following conditions are met:

(a) The agent is a registered person;
(b) The principal is not a registered person;
(c) The supply is not zero-rated;
(d) The supply is directly in connection with the export of goods from New Zealand, or the import of goods into New Zealand, including incidental transportation within New Zealand;
(e) The agent and the principal have agreed that the supply be treated as if it were made to the agent.

(2) **Agent for an absentee principal** [s 59]

A person who carries on a taxable activity in New Zealand on behalf of an absentee principal is required to file GST returns and pay any GST due in relation to that taxable activity. For these purposes, an “absentee” means:

(a) A person, other than a company, who is for the time being out of New Zealand;
(b) A company incorporated outside New Zealand, unless it has a fixed or permanent place in New Zealand for the carrying on of a taxable activity in New Zealand in its own name; or
(c) A company incorporated outside New Zealand which the CIR has declared to be an absentee for GST purposes. The CIR must give the company, or its agent or attorney a notice to this effect, and the company remains an absentee until the declaration is revoked.

580.162 **Auctioneers** [ss 59, 60]

When an auctioneer sells goods on behalf of a client, the sale is normally only taxable if the client is registered for GST and the sale of the goods is in the course of the client’s taxable activity. However, with the agreement of the client, an auctioneer can treat a sale as if it were a supply made by the auctioneer and not by the client. This means that the auctioneer will charge GST on the supply. In these circumstances the auctioneer may either recover the GST from the principal or deduct it from the proceeds of the sale.

580.164 **Company amalgamations** [s 61A]

An “amalgamated company” is the company which exists following an amalgamation under the Companies Act. An “amalgamating company” is a company which amalgamates to form an amalgamated company [see 180 COMPANIES — AMALGAMATION].

In general, goods and services acquired during a company amalgamation are ignored for GST purposes. The specific provisions are as follows.

If a registered amalgamated company acquires goods and services from an unregistered amalgamating company during an amalgamation, the amalgamating company is deemed not to have supplied those goods and services and the amalgamated company is deemed not to have paid for them. Any subsequent adjustments required under s 21 assume that the goods and services were acquired at the same time, for the same purposes and for the same cost as applied to the amalgamating company.

If an unregistered amalgamated company acquires goods and services from a registered amalgamating company during an amalgamation, the supply of goods and services is deemed to have been for a consideration equal to their open market value at the date of amalgamation.
Any adjustment for non-deductible entertainment expenditure, which the amalgamating company would have been required to make had it not amalgamated, must be made instead by the amalgamated company.

Any input deduction for bad debts, which would have been available to the amalgamating company had it not amalgamated, is available instead to the amalgamated company.

When an amalgamating company ceases to exist on amalgamation, all the supplies made by the amalgamating company are treated as having been made by the amalgamated company for the purposes of determining whether the amalgamated company has exceeded the $60,000 compulsory registration threshold (formerly $40,000, before 1 April 2009).

580.166  Penalties and use of money interest  [s 61B]

The penalties and offences in Part 9 of the TAA apply to GST from 1 April 1997 [see 1110 PENALTIES AND INTEREST].

Use of money interest applies to over- and under-payments of GST [see 1110.290, 1110.295].

580.167  Compensation payments

For GST to apply to a court award or out of court settlement, the payment must be consideration for a supply of a good or service, or be an adjustment to the amount of consideration for an earlier supply. There must be some element of reciprocity to link the consideration to that supply. The CIR has issued an interpretation statement on the applicability of GST to compensation payments and court awards [see TIB vol 14:10 (October 2002) at 21-38, TES 5 (June 2003) 72].

In Commissioner of Inland Revenue v New Zealand Refining Co Ltd (1997) 18 NZTC 13,187 (CA), payments totalling $85 million made by the Crown to an oil refining company as an inducement for the company to remain in operation were held not to be for a supply for GST purposes. The payments were received in the course of a taxable activity but they were not in consideration for any supply made by the company. The Court stated that it is fundamental to the GSTA that the tax is levied on or in respect of supplies. It is not a tax on receipts or turnover.

GST is not payable on compensation payments that the Government makes to Maori people for the confiscation of land and the destruction of goods and chattels. A supply must take place before GST is payable. Compensation payable in these circumstances is payable under statute. It is not consideration for the supply of goods and services as no supply has taken place. This situation must be distinguished from amounts received for the supply of goods or services (eg a Government grant to a registered organisation) [see TIB vol 4:7 (March 1993) at 4].

The Maori Reserved Land Amendment Act 1997 provides for the payment of compensation to lessees and owners of leased Maori reserved land. Owners may be compensated for delays in moving to market rents, and lessees may be compensated for the more rapid move to market rents than the original lease agreements provided for. Both parties may also be compensated for additional transaction costs involved (for example legal fees and valuation costs). Such compensation payments are exempt from income tax, and they are not treated as consideration for the supply of goods and services for GST purposes [see TIB vol 10:2 (February 1998) at 2].

580.168  Records  [s 75]

All registered persons who supply goods and services in New Zealand must keep sufficient records in the English language to enable Inland Revenue to ascertain the person’s GST liability. Copies of all records issued by the registered person (such as tax invoices and credit notes) must also be kept. These records must be kept in New Zealand for at least seven years after the end of the taxable period to which they relate. The CIR may authorise some or all records to be kept outside New Zealand, or in a language other than English, on application from the registered person.

The records retained must include:
Goods and Services Tax

(a) A record of all goods and services supplied by or to the registered person showing sufficient detail to enable the goods and services, and the suppliers or the agents, to be readily identified by Inland Revenue, and all invoices, tax invoices, credit notes and debit notes relating to those supplies.

(b) The charts and codes of account, the accounting instruction manuals and the system and program documentation which describes the accounting system.

(c) Any list of debtors or creditors required to be provided following a change in accounting basis, or when a new rate of tax comes into force.

The term “records” includes:

(a) Books of account recording receipts, payments, income, or expenditure;
(b) Vouchers;
(c) Bank statements;
(d) Invoices;
(e) Tax invoices;
(f) Credit notes;
(g) Debit notes;
(h) Receipts;
(i) Any other documents necessary to verify the entries in any books of account.

Records are not required to be kept if the registered person has been so notified in writing, or if the registered person is a company which has been liquidated.

Inland Revenue may extend the seven-year retention period by a further period not exceeding three years by notifying the registered person in writing before the end of the seven-year period. This may be done where Inland Revenue is auditing or investigating the affairs of the registered person, or where Inland Revenue intends to conduct such an audit or investigation within the three-year extended period.

580.170 Effect of alteration in law [ss 78, 78D]

“Alteration in the law” means an enactment resulting in a supply of goods and services being charged with or exempted from GST, or the rate of GST applying to a supply of goods and services being increased or decreased.

Where a supplier and a recipient have entered into an agreement for the supply of goods and services, and as a result of an alteration in the law the amount of GST payable in respect of that supply changes, the agreement is deemed to be modified as follows:

(a) Where the change in law results in the supply being charged with GST, or increases the amount of GST charged on the supply, the price payable is increased by the amount of GST, or the increase in GST, as appropriate.

(b) Where the change in law results in the supply being exempted from GST, or reduces the amount of GST charged on the supply, the price payable is reduced by the amount of GST, or the reduction in GST, as appropriate.

This provision does not apply:

(a) Where the agreement for supply expressly excludes any such change in law having effect;
(b) If the change in law has already been taken into account. Note this paragraph has been repealed with effect from 1 October 2010;
(c) Where the agreement is entered into more than three months after the change in law;
(d) To require a public authority to alter the amount it pays for a supply of goods and services where the consideration is in the nature of a grant or subsidy; or
(e) The reverse charge mechanism in respect of imported services [see 580.101].
The meaning of “subsidy” in (d) above was considered in *de Morgan v Director-General of Social Welfare* (1996) 17 NZTC 12,441 (HC). The owners of a rest home entered into an agreement with the Department of Social Welfare (DSW) to provide rest home facilities to retired persons in return for an agreed fee. The fee was met partly from the beneficiaries’ superannuation or welfare benefits and partly by a payment from the DSW. Shortly after the agreement was entered into, the rate of GST was increased from 10 per cent to 12.5 per cent. The agreement made no reference to GST. The appellants claimed that they were entitled to recover the increase in GST from the DSW under s 78(2) of the GSTA. The DSW claimed exemption as a public authority under the second proviso to that subsection [see (d) above]. The High Court ruled that the “top up” payment by the DSW was not a subsidy in relation to the rest home operator (although it is a subsidy to the beneficiary in respect of whom it was paid). It was merely part of the consideration provided for a commercial supply arrangement. The rest home operators were entitled to recover the increase in GST from the DSW.

In *Kena Kena Properties Ltd v Attorney-General* (2002) 20 NZTC 17,429 (CA), it was held that s 78(2) is intended to clarify that no increase in a subsidy would follow from increases in GST. It did not have an effect of requiring a subsidy to be made to the supplier of the service. This decision was upheld by a majority of the Privy Council: *Kena Kena Properties Ltd v Attorney-General* [2002] 2 NZLR 597, (2001) 20 NZTC 17,433 (PC).

Any increase in consideration payable as a result of an alteration in the law is recoverable by the supplier from the recipient of the supply.

If an alteration in the law has retrospective effect, the above provisions also have retrospective effect.

The repeal or amendment of any provision in the GSTA does not affect the liability or right of any person or the Crown that existed under that provision before that repeal or amendment occurred. In particular, the following are not affected:

(a) Any liability to GST, or to any fine or penalty, arising under a repealed or amended provision;
(b) The right of the Crown to any tax, fee, fine or penalty imposed under a repealed or amended provision;
(c) All acts and proceedings for the assessment or recovery of any revenue, tax, fine or penalty assessed under a repealed or amended provision;
(d) All proceedings in respect of offences committed or alleged to be committed in respect of a repealed or amended provision.

### 580.172 Consequences of change in rate of GST [ss 78A, 78B, 78BA, 78C]

The rate of GST has been increased twice since GST came into force 1 October 1986 and provided for a rate of 10 per cent. The first increase was on 1 July 1989, when the rate was raised to 12.5 per cent. The second increase was on 1 October 2010, when the rate was raised to 15 per cent. The increase to 15 per cent changes the tax fraction to be used for all calculations from 1/9 to 3/23 (equivalent to 15/115).

A number of transitional provisions apply where there is a change in the GST rate. These are explained below.

(1) **Effect on contracts [s 78]**

Section 78 provides a mechanism whereby the consideration under a contract entered into prior to the change in rate can be amended to take into account the effect of the change. It allows the supplier to recover the additional GST from the recipient and also allows the recipient to benefit from a reduction in tax should the rate be decreased.

The provision also applies where there is an alteration in law which changes the GST treatment of a transaction from, for example, exempt to taxable or from zero-rated to standard-rated, or vice versa. However, it expressly does not apply to the introduction of the reverse-charge mechanism which applies to imported services.

The provision does not apply where there is an express provision in the contract excluding an alteration in the consideration.
All amounts prescribed by regulation or statute are automatically increased or decreased where the GST rate changes. However, the automatic adjustment does not apply to amounts required to be paid by any public authority other than a public authority.

(2) Returns for GST periods where two different GST rates apply [s 78A]

It is possible that a registered person’s GST period will not begin on the same day as that on which the new GST rate comes into force. Where this occurs, the person is required to file the return in two parts. The first part covers that part of the GST period that occurs prior to the date of the rate change. The second part covers the period from the date of the rate change to the end of the person’s GST period.

(3) Returns furnished following rate change [s 78B]

Where a registered person, on or after the date on which the GST rate changes:

(a) Makes or receives a payment and accounts for GST on the payments basis; or
(b) Makes a payment for a secondhand good and accounts for GST on the invoice basis; or
(c) Makes a payment for any taxable supply or secondhand good and accounts for GST on a hybrid basis, the transaction is deemed to have incurred GST at the new GST rate.

However, an adjustment is made to ensure that the correct amount of GST is paid. The adjustment requires the person to identify the supplies which require adjustment. This is the debtors and creditors immediately prior to the date on which the rate changed. The net amount is multiplied by the difference in the old and new GST rates. If creditors exceed debtors, the amount is treated as output tax in the return period. If debtors exceed creditors, the amount is offset against the GST liability and any remaining balance is refunded unless it is used by the CIR for the payment of tax outstanding under the terms of s 46. These adjustments are recorded on a special form.

Example:

Jason runs a small business and accounts for GST on a two-monthly cash basis. His return periods end with the last day of the uneven months of the year. As at 30 September 2010, Jason had the following debtors and creditors:

<table>
<thead>
<tr>
<th>Debtors (GST-inclusive at 12.5%)</th>
<th>Creditors (GST-inclusive at 12.5%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Three invoices for services rendered $11,250.00</td>
<td>Office rental $1,125.00</td>
</tr>
<tr>
<td>Electricity $225.00</td>
<td>Stationery $112.50</td>
</tr>
<tr>
<td><strong>Total</strong> $11,250.00</td>
<td><strong>Total</strong> $1,462.50</td>
</tr>
</tbody>
</table>

The net amount of the debtors and creditors is $9,787.50 ($11,250.00 - $1,462.50).

This net figure is multiplied by the difference between the old and new GST rates, being 2.5 per cent (15% - 12.5%).

The amount of the adjustment is $9,787.50 x 2.5% = $244.68.

As Jason’s debtors exceeded his creditors, the amount of the adjustment is deducted from the net input tax that he is required to pay for the period.

(4) Insurers’ recoveries [s 78AA]

Where:

(a) An insurer accepts a claim before 1 October 2010 and either pays the claim or unconditionally agrees the amount to be recovered; and

(b) The amount recovered is received after 1 October 2010;

the insurer has the option of treating the amount recovered as being subject to GST at the rate of 12.5 per cent.

(5) Finance leases [s 78AA]

Where a finance lease is entered into before 1 October 2010, and the term of the lease is not more than five years, the provider of the lease has the option of continuing to account for GST at the rate of 12.5 per cent rate for...
the remainder of the lease. Where this option is taken, the lease provider is required to advise any GST registered lessees that the option has been taken and that the lessee must claim any input tax deduction at the 12.5 per cent rate. The notification to lessees must occur within 30 days after 1 October 2010.

(6) Layby sales [s 78AA]
The supply in a layby sale is treated as occurring when the goods are delivered. This means that, under normal rules, layby sales that are not completed before 1 October 2010 will attract the 15 per cent GST rate. However, under the transitional provision, for layby sale agreements that were entered into before 20 May 2010 (Budget day), suppliers have the option of treating payments received before 1 October 2010 as being subject to the 12.5 per cent GST rate. Payments received on or after 1 October 2010 would be subject to the 15 per cent rate. Where this option is taken, the GST relating to payments received before 1 October 2010 must be included in the supplier’s September 2010 GST return.

(7) Invoices issued after 1 October for pre-1 October supplies [s 78AA] Where goods or services are supplied before 1 October 2010 but are invoiced after that date, the supplier has the option of issuing the invoice using the 12.5 per cent GST rate. The invoice must be issued no later than 11 October 2010 and payment of the invoice must be due no later than 60 days from the date of the invoice. This provision would typically apply to such things as electricity and telephone services.

(8) Periodic payments [s 78AA] A contract that is for a period of one year, and is reviewed annually, may provide for a single payment or may provide for progressive payments throughout the year. An example would be health insurance. Where the review period under the contract is no more than 396 days, and the review dates span 1 October 2010, suppliers have the option of treating the entire year’s instalments as being subject to GST at the 12.5 per cent rate. Where the supplier takes this option, all of the GST not already accounted for must be accounted for in a GST return for a period ending before 1 October 2010. Suppliers who take this option are required to advise any GST-registered recipient that the option has been taken and that the lessee must claim any input tax deduction at the 12.5 per cent rate. The notification must occur within 30 days after 1 October 2010. Where this option is not taken, the supplier is likely to need to issue a credit note and a debit note to account for the increased GST on the remaining part of the contract. As an alternative to issuing debit and credit notes, replacement tax invoices can be issued to replace the original pre-1 October tax invoice to take into account the increased GST payable on the remaining services provided from 1 October.

(9) Private training establishments [s 78B] “Private training establishments” (PTEs) are registered with the New Zealand Qualifications Authority. They are required to use a trust arrangement where students pay their course fees in full. As the course is delivered, the trustee progressively pays the fee to the private training establishment. As the services are supplied for GST purposes at the time at which the fees are released by the trustee, the organisations will be faced with the prospect of either recovering from the students the additional GST for post-1 October 2010 supplies or paying the extra GST amount even though they have not received it from the students. To alleviate this problem, PTEs are able to treat the entire amount as subject to GST at the 12.5 per cent rate. Where the PTE takes this option, all of the GST not already accounted for must be accounted for in their September 2010 GST return.

(10) Adjustments for debit notes and credit notes [s 78BA] Where a registered person accounts for GST on a payments basis and there has been a change in the GST rate, an adjustment is required to be made in respect of debit and credit notes received or issued under the following circumstances:
(a) The person has made an adjustment under s 78B [see the paragraph “Returns furnished following rate change” above] in respect of that supply; and
(b) The person issues or receives a debit note or credit note before payment has been made or received in respect of the supply. In the case of the recipient of the supply, knowledge that the tax invoice held is incorrect is sufficient to trigger the requirement to make an adjustment.

The adjustment is the amount of the change in the consideration for the supply multiplied by the change in the GST rate. If the result is positive, then it is treated as output tax. If it is negative, then it is treated as input tax.

11) Adjustment where a change in accounting basis occurs [s 78C]

Where a person changes the basis on which they account for GST and that change coincides with or occurs subsequent to a change in the GST rate, an adjustment is required. The calculation is undertaken in accordance with s 19C [see 580.126]. When making the adjustment, no account is taken of the amount of any adjustment under s 78B [see above].

12) Change of use adjustment: Goods or services applied for other than making taxable supplies [s 21CB]

The provisions of s 21CB apply where:
(a) A registered person acquired or produced goods or services for the purposes of making taxable supplies; and
(b) Before 1 October 2010, wholly or partially applied those goods and services for a purpose other than making taxable supplies; and
(c) As a consequence, is required to make an adjustment under s 21 (as modified by s 21D for change of use in contemplation of sale).

Provided that all of the above criteria are satisfied, the person is able to choose to make the adjustment at the GST rate that applied immediately before 1 October 2010 (ie 12.5 per cent).

The provision can be used only for goods or services applied for other than a taxable purpose before 1 October 2010 where the attribution of output tax occurs on or after 1 October 2010. An example of where the provision would apply is where a registered person's GST period spans 1 October 2010.

13) Change of use adjustment: Goods or services applied for making taxable supplies [s 21F]

An amendment has been made to s 21F, which provides an input tax deduction where goods or services acquired for other than making taxable supplies are applied for the purpose of making taxable supplies. The section now requires the GST rate at which the adjustment is made to be the “COU tax fraction”. The “COU tax fraction” is either:
(a) The tax fraction applying at the time at which the adjustment is made, which is 1/9 before 1 October 2010, and 3/23 on and after 1 October 2010; or
(b) The tax fraction that applied at the time at which the goods or services were acquired by the person if they are applied for the purposes of making taxable supplies before 1 October 2010.

This covers the situation where the goods or services were applied for the purposes of making taxable supplies before 1 October 2010, but the adjustment is made after that date. Examples of where the transitional provision would apply are where the person’s GST period spans 1 October 2010, or where a person is making an annual adjustment after the end of the tax year as part of finalising their annual accounts.

TaxNote: Application of this transitional provision is mandatory.

14) Adjustment for fringe benefits and entertainment expenditure [s 21I]

As the GST time of supply of a fringe benefit is deemed under s 21I(3) to be the time at which the benefit is, or is deemed to be, granted or provided, no transitional rule is necessary. GST payable on fringe benefits provided before 1 October 2010 will be calculated at the rate of 12.5 per cent irrespective of the time at which the return is filed.
The GST time of supply for entertainment expenditure is the date on which the return of income is furnished or due (if earlier). This means that a transitional rule is needed to ensure that the amount of the GST adjustment for the non-deductible portion of entertainment expenditure is not excessive. The new s 21I(4B) provides that the time of supply for entertainment is treated as being 30 September 2010, provided that the relevant expenditure was incurred before 1 October 2010. Use of this provision is optional.

(15) Remission of penalties and interest [TAA, s 183AA]
Automatic remission of the late filing penalty, late payment penalty and use-of-money interest applies where, objectively, the penalties are imposed because of the taxpayer’s acts or omissions in respect of the 1 October 2010 change in GST rate; and the penalties are imposed in respect of:
(a) A “GST transitional taxable period”, which is a taxable period that includes 1 October 2010, or includes 1 October 2010 and a later GST taxable period that ends on or before 31 December 2010; or
(b) A taxable period in which an adjustment is required to be made by a person who is registered for GST on the payments basis (see the paragraph “Returns furnished following rate change” above).

Answers to frequently asked questions can be found under the “FAQ” tab on the GST Advisory Panel website www.gstadvisory.govt.nz.

580.174 Administration [ss 79-80]
The CIR, or an authorised officer, and the Chief Executive of the New Zealand Customs Service, or an authorised Customs officer, may exchange information obtained for revenue-gathering purposes, provided it is to be used for that purpose. This ability to exchange information is not prevented by any obligation to secrecy or other restriction on the disclosure of information. Such information must not be disclosed except for revenue-gathering purposes under the GSTA.

580.180 Income tax treatment of GST [ss CH 5, CX 1, DB 2, EE 45, EE 54]
(1) Taxpayer is GST-registered
When a taxpayer is registered for GST, the following rules generally apply to the income tax treatment of GST:
(a) GST charged on taxable supplies made, and any GST refund received from Inland Revenue is excluded income and is not subject to income tax.
(b) GST charged or levied on taxable supplies received, and any GST paid to Inland Revenue, are not deductible.
(c) In calculating the depreciation deduction allowable, the cost of the asset is its GST-exclusive cost. However, there are some exceptions to this general rule:
(a) An income tax deduction is allowed for the GST adjustment arising:
   (i) Under s 5B when imported services are treated as being supplied in New Zealand and the reverse charge mechanism applies [see 580.101];
   (ii) Under s 21(1) when an asset acquired principally for making taxable supplies is subsequently used for a non-taxable purpose. For example, an asset acquired for making taxable supplies is used for making exempt supplies [see 580.126];
   (iii) Under s 21I when supplies made to employees are subject to FBT [see 580.126]. The adjustment is deductible only if the expenditure or depreciation would otherwise be deductible under the ITA.
(b) Income includes the GST adjustment arising under s 21(5) when a private or non-business asset is used for the purpose of making taxable supplies [see 580.127].
These GST adjustments are not taxable or deductible (as appropriate) if the adjustment results from a permanent change in the principal use of the asset. If there is a permanent change in the principal use of a depreciable asset, the cost of the asset is:

(a) Reduced, when the adjustment results from a change from a non-taxable to a taxable purpose;
(b) Increased, when the adjustment results from a change from a taxable to a non-taxable purpose.

(2) Taxpayer is not GST-registered or goods and services acquired for exempt purpose

When a taxpayer is not registered for GST or if a GST-registered taxpayer purchases goods and services to make exempt supplies, the following rules apply:

(a) No GST is charged by the taxpayer on the supplies it makes. Therefore, the issue of GST in relation to income does not arise.
(b) GST charged on taxable supplies received is deductible. This is because the taxpayer is unable to claim an input tax deduction in relation to those taxable supplies. Therefore, the cost of the goods and services includes the GST charged on them.
(c) In calculating the depreciation deduction allowable, the cost of the asset is its GST-inclusive cost.

For the impact of GST on the preparation of income tax accounts [see TIB vol 7:1 (July 1995) at 8-9, 580.124].

580.182 Depreciation when asset transferred to exempt use

Where an asset is transferred to be used for GST exempt purposes, no deduction is available for the GST payable to Inland Revenue. However, the cost price of the capital asset concerned is increased by the amount of GST which becomes payable by the taxpayer as output tax. Accordingly, an income tax deduction is gained by way of an increased depreciation charge against the asset concerned.

Example:

Motor vehicle acquired by a retail store for delivery of customer purchases on 1 April 20X1:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost (GST inclusive)</td>
<td>37,125</td>
</tr>
<tr>
<td>Input tax deduction claimed ($37,125 x 3/23)</td>
<td>4,842</td>
</tr>
<tr>
<td>Net cost</td>
<td>32,283</td>
</tr>
<tr>
<td>Depreciation to 31 March 20X3 (at 13.5 per cent straight-line)</td>
<td>4,358</td>
</tr>
<tr>
<td>Adjusted tax value</td>
<td>28,682</td>
</tr>
<tr>
<td>Depreciation to 31 March 20X2 (at 13.5 per cent straight-line)</td>
<td>4,358</td>
</tr>
<tr>
<td>Adjusted tax value</td>
<td>24,284</td>
</tr>
</tbody>
</table>

On 1 November 20X3 the motor vehicle is transferred to the residential rental (GST-exempt) business arm of the firm:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open market value of vehicle</td>
<td>16,500</td>
</tr>
<tr>
<td>GST output tax payable ($16,500 x 3/23)</td>
<td>2,152</td>
</tr>
<tr>
<td>New adjusted tax value 1 April 20X3 (24,284 + 2,152)</td>
<td>26,436</td>
</tr>
</tbody>
</table>

580.183 Avoidance [s 76]

The anti-avoidance provision of s 76 is consistent with the general anti-avoidance provision of s BG 1. These provisions apply to any arrangement that directly or indirectly has tax avoidance as:

(a) Its purpose or effect; or
(b) One of its purposes or effects, whether or not another purpose or effect relates to business or family dealings, if the purpose or effect is not merely incidental.

A tax avoidance arrangement is void as against the CIR for GST purposes. The CIR may adjust the amount of GST payable by, or the refund to, a registered person affected by the arrangement, and thereby counter any tax advantage obtained by the person under the arrangement.
Goods and Services Tax

(1) Cases

In Ch’ elle Properties (New Zealand) Ltd v Commissioner of Inland Revenue (2004) 21 NZTC 18,618 (HC), the taxpayer had claimed GST input tax credits on the purchase of 114 properties. In each case, a small deposit was paid to the vendor with the balance being payable at settlement, a gap of 10 to 20 years. As the taxpayer was registered on the invoice basis and the vendors on the payments basis, the purchaser was able to claim GST on the entire purchase price while the vendors were liable for output tax only on the amount of the deposit. The High Court found the fact that a scheme complied with the specific requirements of the Act does not preclude a finding of tax avoidance. Section 76 does not require proof of intention. It is directed to the effect or purpose of the arrangement. It requires the arrangement to be assessed by reference to the principles which underly the Act. A tax advantage does not have to be established before the CIR can treat an arrangement as void.

The case, which was an appeal from the findings of the TRA in TRA Case W22 (2003) 21 NZTC 11,212, was itself appealed to the Court of Appeal as Ch’ elle Properties (New Zealand) Ltd v Commissioner of Inland Revenue [2007] NZCA 256. In dismissing the appeal, the Court of Appeal stated that an arrangement that complies technically with the GSTA 1985 can nonetheless be struck down by s 76, which provides for an overview and assessment of the combined effect of the individual components of the arrangement. The Supreme Court declined the taxpayer’s application for leave to appeal the decision.

In Glenharrow Holdings Ltd v Commissioner of Inland Revenue [2007] NZCA 346, (2007) 23 NZTC 21,564, the Court of Appeal (by majority) dismissed the taxpayers appeal holding that s 76 applied to the arrangement. The case concerned the purchase of a mining licence for $44.92 million when previous prices offered ranged from $100 to $10,000. The licence was to expire in approximately three years and there was legislation before Parliament that could substantially impact on the intended mining activity. The purchase was funded in part by a vendor loan, with the obligation to repay being, for all intents and purposes, dependent on the success of the mining activity. The findings of the Court of Appeal were upheld by the Supreme Court in Glenharrow Holdings Ltd v Commissioner of Inland Revenue [2008] NZSC 116, [2009] 2 NZLR 359, (2009) 24 NZTC 23,236. The Supreme Court found the arrangement entered into by the taxpayer was void under s 76. On an objective view, the effect of the arrangement was to produce a GST refund totally disproportionate to the economic burden undertaken by the taxpayer or the economic benefit obtained by the vendor. In order for the CIR to carry out a reconstruction under s 76, the CIR does not have to demonstrate that the parties subjectively or consciously had the purpose of defeating the intent and application of the GSTA 1985. The natural and sensible reading of s 76 is to ask what objectively was the purpose of the arrangement, which in turn requires examination of the effect the arrangement. In order to discern that objective purpose of the arrangement, it is necessary to work “backwards” from its effect (ie what it has achieved). The intent and application of the GSTA 1985 will be defeated if an arrangement has been structured to enable the avoidance of output tax, or the obtaining of an input deduction in circumstances where that consequence is outside the purpose and contemplation of the relevant statutory provisions.
Chapter 600

Goodwill

600.10 Goodwill — income and timing of income

Goodwill is income when received by:

(a) An owner of land from any lease affecting the land [s CC 1]: Hawkless v Commissioner of Inland Revenue (1983) 6 NZTC 61,646 (HC). In such a case, the goodwill is equivalent to additional rent calculated over the whole term of the lease but payable at the commencement as a premium. A sham transaction in avoidance was at issue in TRA Case K77 (1988) 10 NZTC 619.

(b) Any person on the sale or other disposition of any real or personal property. This only applies if the person carries on a business of dealing in such property, or if the property was acquired with a view to selling or otherwise disposing of it [see 710.65]. In this situation, the amount received for goodwill is income.

In this context, the term “owner of land” means a person who is the owner of any estate or interest in land, including inter alia any right to the possession of land. Accordingly, a lessee is an “owner of land” for this purpose, and any sum received as goodwill on the grant of a sublease is gross income. However, goodwill derived from the sale of a lease (instead of subletting), or any other property, real or personal (eg a licence), is normally a capital receipt (and not income). This exception does not apply if the vendor carries on a business of dealing in that class of property or has acquired the property with a view to selling or otherwise disposing of it.

The amount received for the goodwill of the lease of licensed premises is the typical instance of goodwill being income. The full amount received is assessable in one sum in the year of receipt. However the taxpayer may apply to the CIR to have the amount spread over the year of assessment and the five succeeding years in accordance with s EI 7.

The findings in the following cases use terminology in force prior to the Taxation (Core Provisions) Act 1996. However, the principles should continue to apply.

In Romanos Motels Ltd v Commissioner of Inland Revenue [1973] 1 NZLR 435 (CA), the taxpayer company granted a lease of its motel property to a company to be formed on terms which provided for an annual rental of $10,000, and for the sale of the “goodwill and lease” for $5,000, and the furniture and fittings for $12,000. The question at issue was whether the sum of $5,000 for the sale of the goodwill and lease was assessable in terms of s 88(1)(d) of the Land and Income Tax Act 1954. It was held on the facts of the case that the $5,000 was properly assessed as income under the above provision. In order to be caught, a goodwill payment must relate so closely to the site or locality as to be inseparable from it. On the facts, the motel business required a licence which related solely to the land owned by the taxpayer. What the taxpayer sold to the purchaser was the right to carry on an existing business that could only be carried on at the premises comprised in the lease. The business was not one that could be transferred at will to other premises.

In Gaynor Fussell Transport Ltd v Commissioner of Inland Revenue (1973) 3 ATR 679 (SC), the taxpayer was a carrying company employing 50 drivers, which entered into additional contracts with seven or eight owner-drivers. Each owner-driver was required to obtain a goods service licence and undertake to work exclusively for the company. The company undertook to find work for the owner-driver, even if this meant standing down its own trucks at times. In consideration of the company guaranteeing work for an owner-driver, he agreed to pay the company $3,000 (plus interest) in monthly instalments over the five year term of the agreement. Inland Revenue included the $3,000 payable by each owner-driver in the income of the company, and the company objected, contending that the $3,000 was paid for a covenant in restraint of trade and as such should be treated as a capital receipt to the company. It was held that the sums in question were
part of the profits of the company in the course of carrying on its business in a particular way, and were 
receipts of an income nature, not of capital.

In TRA Case H66 (1986) 8 NZTC 473, involving the sale of a motor vehicle dealership, the goodwill sold 
in the particular circumstances was held to comprise both personal and site goodwill, only the proportion of 
the total goodwill price representing the latter was assessable.

Two cases were considered in Capel v Commissioner of Inland Revenue (1987) 9 NZTC 6,195 (HC). The 
Capel partnership owned three fast food outlets. The company “Melco” owned the chattels and equipment 
used in the outlets and leased them to the operators. The partnership disposed of two outlets on the same 
terms, each by way of a licensing agreement. The partnership retained the shop leases and in each case 
received a goodwill payment as well as a fixed weekly share of trading profits from the purchasers. The third 
outlet was sold by the partners to their wives for a goodwill payment. Melco began to manufacture ice cream 
for the various outlets and in order to ensure security of outlets, future licensing agreements incorporated a 
provision whereby 50 per cent of any goodwill obtained by a licensee on sale would be paid to Melco. Several 
payments were received. Further shops were established where Melco was not a party to the arrangements. 
However, Melco’s interest was protected by a clause requiring its consent to any assignment or subletting. 
Payments were made to Melco in recognition of its assistance in establishment of the business. Inland 
Revenue assessed both taxpayers on goodwill received. On the above facts, it was held that:

(a) The payments received in relation to the first two dispositions were not assessable. They were not 
within the then s 65(2)(a) of the ITA 1976 [now s CB 1] as the principal motive was to ensure that 
purchasers had a financial interest. This suggested a capital asset disposition and not an attempt to 
obtain an income. There was also an insufficient nexus between the grant of licences and goodwill 
payments to ensure assessability, the facts showing that business success was dependent neither on 
the premises nor on their location but on the nature of the business. It was to this latter matter that 
the goodwill related.

(b) The goodwill payment to the partners from their wives was assessable under the principles of 
Romanos Motels Ltd (above).

(c) Melco’s activity pattern showed an intention to achieve a payment of an income in relation to the 
disposition of businesses for which it had some interest. Accordingly, due to the pattern of payments 
the income was assessable.

600.20 When goodwill deductible

Under s EZ 8, a deduction is allowed for a premium or a goodwill payment by a lessee to a landlord, or by 
a sublessee to a head lessee, on the grant of a lease or sublease, or on the renewal of a lease, or sublease where 
the grant or renewal occurring before 1 April 1993. After this date such payments are treated as depreciable 
tangible property.

In other situations, payments for goodwill are usually an acquisition of a capital (intangible) asset. Therefore, 
the cost of that goodwill is not allowed as a deduction [s DA 2(1)] and cannot be depreciated as it is not 
depreciable intangible property.

There is some doubt as to whether payments to preserve goodwill are an allowable deduction. In considering 
the deductibility of a payment in Buckley & Young Ltd v Commissioner of Inland Revenue (1975) 
2 NZTC 61,036, (1975) 1 TRNZ 180 (SC), the Court stated:

“It is, of course, perfectly clear that if the purpose of the payments in the instant case was to 
secure the operation of the restrictive covenants until such time as T attained the age of 60 or 
sooner died, then the payments made by the company were of a capital nature and not deductible. 
The payments would have been made to preserve goodwill, a capital asset.”
Chapter 610

Government Grants and Suspensory Loans

610.05 Government grants to businesses [s CX 47, DF 1]

Sections CX 47 and DF 1 apply to any business-related grant made to a taxpayer by a local authority or a public authority.

The payments may be in the nature of a subsidy or grant or may be a grant-related suspensory loan. However, any advance or loan other than a grant-related suspensory loan is not covered by the provisions.

The provisions do not apply to:

(a) Large budget screen production grants where the final application for the grant is made on or after 1 October 2009 and the company has not incurred $3 million or more in expenditure on the project before 1 July 2008; or

(b) A grant made under the Agriculture Recovery Programme for the lower North Island and Eastern Bay of Plenty, to the extent to which the grant relates to expenditure which was incurred by the recipient before the grant was made and for which the recipient would be allowed a deduction under general tax law.

The provisions are optional to the extent to which the grant is made to a person in relation to their business as a technology development grant or under a technology transfer voucher and the following conditions are met:

(a) The payment of the grant is withheld until the conditions of the grant are satisfied;

(b) The person would be entitled to a deduction or a depreciation loss for the expenditure to which the payment relates.

A grant-related suspensory loan is a loan that is:

(a) Made by a public authority, and not designated by that public authority as being a “specified suspensory loan”, and which provides that the loan may be wholly or partly remitted; or

(b) Made by the Rural Banking and Finance Corporation of New Zealand as an “irrigation suspensory loan” or a “West Coast drainage suspensory loan”.

Where a grant is made to any taxpayer for expenditure incurred that is an allowable deduction, the amount of the allowable deduction is reduced by the amount of the grant, and the grant is excluded income of the taxpayer and therefore not subject to tax.

Example 1:

A grant of $70,000 is received to be applied towards deductible expenditure of $80,000. The allowable deduction to the taxpayer is $10,000 and no part of the grant is treated as assessable income.

Example 2:

A grant may be made to a taxpayer towards expenditure incurred in the acquisition, construction, installation, or extension of an asset which is subject to an allowable depreciation deduction. When calculating the value of the asset for depreciation, the expenditure on the asset is reduced by the amount of the grant, and the grant is excluded income of the taxpayer and therefore not subject to tax.

Example 2:

A grant of $40,000 is received towards the purchase of a depreciable asset costing $50,000. The value of the asset for depreciation purposes is $10,000 and no part of the grant is treated as assessable income.
The CIR has power at any time to alter any assessment to give effect to these provisions, notwithstanding the time bar restricting the alteration of assessments.

A taxpayer who has received a suspensory loan for social policy reasons from a specified government agency is not required to pay tax when the loan is remitted [ss EZ 38(6), EW 45]. The schedule to the Income Tax (Social Assistance Suspensory Loans) Order 1995 lists three social assistance suspensory loans:

(a) Any suspensory loan made by the Housing NZ Corporation under the “Right to Buy” programme;
(b) Any suspensory loan made by the Department of Social Welfare under s 14 or s 16A of the Disabled Persons Community Welfare Act 1975; and
(c) Any suspensory loan made by the Department of Social Welfare under Part 9 of the War Pensions Regulations 1956.

Special rules apply to technology development grants and technology transfer vouchers [see 1240.35].

610.10 Repayment of grant-related suspensory loans [s DF 2]

When a taxpayer is required to repay a grant-related suspensory loan, the tax effect mirrors that which applied to the receipt of the loan.

To the extent to which the grant-related suspensory loan was used to meet an item of deductible expenditure, a deduction is allowed equal to the amount of the repayment.

To the extent to which the grant-related suspensory loan was used to acquire, construct, install or extend a fixed asset, the taxpayer is allowed a deduction for any depreciation which the taxpayer has been denied as a result of receiving the grant-related suspensory loan.

A statement by the grantor is conclusive as to whether the grant was used to meet revenue or capital expenditure.

610.20 Specified suspensory loans [s CF 2]

A specified suspensory loan has taxation consequences only when the loan or part thereof is remitted.

A "specified suspensory loan" is a business-related loan from a public authority where the loan is designated by that public authority as being a specified suspensory loan.

Specified suspensory loans are subject to the following rules:

(a) The amount of a specified suspensory loan is not treated as assessable income at the time the loan is made;
(b) If and when the taxpayer’s liability for the loan is remitted, the amount remitted is deemed to be income derived equally over the year of remission and the following two years;
(c) Any amount that is deemed to be income in either the second or third income year can be allocated by the taxpayer to an earlier income year in that three-year period;
(d) Where the taxpayer ceases to carry on the business for which the loan was granted before the full amount remitted has been included in assessable income, the unassessed balance is taxable in the year in which the taxpayer ceases to carry on the business;
(e) The expression “income year” refers to the taxpayer’s corresponding accounting year where the taxpayer has a non-standard balance date;
(f) The conversion of the loan into a grant does not affect the taxpayer’s deductions for depreciation; and
(g) If the loan is not converted to a grant (eg if the taxpayer does not meet the required targets, it will continue to be ignored for tax purposes).

The CIR’s policy on the tax treatment of remitted specified suspensory loans is set down in TIB vol 7:1 (July 1995) at 7-8.
Chapter 620

Group Investment Funds

620.10 Group investment fund income

A group investment fund is a trust for investment purposes which can be set up only by a trustee company or the Public Trustee. It is a pool of funds which has been gathered from sources such as estates, trusts and other small investors and which is available to the trustee company or the Public Trustee for investment in authorised trustee securities.

A trustee of a group investment fund is required to file separate returns of taxable income for an income year in relation to Category A and Category B income.

Category A income is the proportion of the income of the fund that is not Category B income or is not income of a designated group investment fund.

Category B income is the proportion of the fund’s income derived from investments in the fund:

(a) From the following designated sources:

(i) Trusts that are estates, or are created by statute or Court order; and

(ii) Charitable trusts; or

(b) That were made prior to 23 June 1983 but are not made from designated sources. This generally represents funds invested by the trustee of the group investment fund as an agent for the investors (agency funds).

A designated group investment fund is any group investment fund that invests only in:

(a) Trustee securities authorised by s 4(1)(a) to (j) of the Trustee Act 1956, read as if the Trustee Amendment Act 1988 had not been enacted; or

(b) A forestry business, but only for land owned or held on 22 June 1983.

A group investment fund is treated as a company for its calculation of taxable income arising from Category A income and for resident withholding tax purposes [s YA 1, see 1260.40].

In relation to Category B income and income derived by a designated group investment fund, a group investment fund is treated as a trustee. Sections DV 1, DV 2, DV 4, GB 22, subpart HC and s HD 12 apply for this purpose.

An investor’s interest in a group investment fund (GIF) which derives category A income is deemed to be shares, and the nominal amount of the interest of the investor is deemed to be paid up on those shares [s YA 1].

Where the group investment fund has elected to become a PIE [see 1130 PORTFOLIO INVESTMENT ENTITIES], See also 40 AGENCY where a trustee of a group investment fund is an agent for absentee investors [s HD 23].

620.20 Group investment fund dividends [ss CD 4(1), CD 5(1), HC 1(2)]

From 1 April 1999, distributions to a superannuation fund are treated as a distribution of a dividend. The share repurchase rules will apply to exclude the capital portion from the dividend [see TIB vol 10:12 (December 1998) at 18-19, s CZ 14].

The provisions in the ITA 2007 that apply to companies, shares, or shareholders, apply to dividends of a group investment fund as if it were a company, the deemed shares were the only shares, and the investors holding the deemed shares were the only shareholders.
Group investment fund redemptions may be made from available subscribed capital. Redemptions may only give rise to a dividend once all the subscribed investment has been paid out and the group investment fund begins to pay out reserves. However, this may be negated through elections made by the group investment fund for a different treatment [s CZ 13].
Chapter 640

Hire Purchase Agreements

640.10 Hire purchase agreements
When a person (referred to as the “seller”) provides personal property to another person (referred to as the “buyer”) under a hire purchase agreement:
(a) The agreement is treated as a sale by the seller to the buyer on the date the term of the agreement starts;
(b) The seller is treated as giving a loan to the buyer for the property;
(c) The buyer is treated as using the loan to buy the property; and
(d) The depreciation rules, the financial arrangement rules and the other provisions of the ITA 2007 apply to the agreement.

This does not apply to property that is livestock or bloodstock.

For the seller, the amount of the loan is determined under s EW 32. For the buyer, the amount of the consideration is determined under ss EW 32 and EW 33 [see 470.90]. The buyer is treated as the owner of the property, and the seller is not treated as the owner, for the purposes of the depreciation rules.

If the seller takes an amount calculated under s FA 15 into account as the cost of trading stock or in the calculation of their net income, the seller is denied a deduction under ss DB 14 or DB 31 (debts sold at a discount and bad debts) for an amount owing under the hire purchase agreement.

640.15 Definition of hire purchase agreement
A “hire purchase agreement” is an agreement under which goods are let or hired with an option to purchase, or purchased by instalment payments, and in either case the purchaser is given possession of the goods before the total amount payable has been paid. The way in which the agreement describes the payments is irrelevant to the definition. A hire purchase agreement includes:
(a) An agreement to sell goods at retail where the buyer grants security over the goods to the seller for some or all of the purchase price, and the property in the goods passes to the buyer subject to the security;
(b) A sale and loan agreement where a person (either the seller or a third party) lends money on the security of the goods bought, and some or all of the purchase price is paid out of the loan proceeds. If the loan is made by a third party, it must be arranged by the seller and the third party must be engaged in the money lending business or habitually lend money in the course of their business.

A hire purchase agreement does not include an agreement:
(a) Under which property in the goods passes absolutely to the purchaser at the time the agreement is entered into, or at any time before delivery of the goods, unless the agreement is an agreement under which goods are let or hired with an option to purchase, or purchased by instalment payments, and in either case the purchaser is given possession of the goods before the total amount payable has been paid;
(b) Made otherwise than at retail;
(c) To the extent to which the property that is the subject of the agreement is livestock or bloodstock.
640.20 Buyer does not acquire ownership of property [ss FA 15, FA 16, FA 17]

If a hire purchase agreement ends and the buyer (or an associated person) does not acquire ownership of the property, the seller is treated as buying the property from the buyer for an amount equal to the outstanding balance, and the buyer is treated as selling the property to the seller for the same amount. The date of the sale is the date the agreement ends.

The outstanding balance is calculated using the formula:

\[
\text{net balance due on termination} - \text{buyer’s termination payment} + \text{seller’s termination payment}
\]

Where:

“Net balance due on termination” is the net balance due under the hire purchase agreement on the date the agreement ends, less any repossession costs and expenses.

“Buyer’s termination payment” is the sum of the following amounts, as applicable:

(a) An amount paid by the buyer, or an associated person, to the seller, or an associated person, under the agreement;
(b) An amount paid as a consequence of the agreement ending; and
(c) An amount required to be taken into account by the buyer under the base price adjustment [see 540.80] or in item “a” of the formula in s EZ 38(1).

“Seller’s termination payment” is the sum of the following amounts, as applicable:

(a) An amount paid by the seller, or an associated person, to the buyer, or an associated person, under the agreement;
(b) An amount paid as a consequence of the agreement ending; and
(c) An amount required to be taken into account by the buyer under the base price adjustment or by the seller in item “b” or “c” of the formula in s EZ 38(1).

The outstanding balance is taken into account as the consideration paid by the buyer to the seller under the hire purchase agreement, when calculating the base price adjustment in s EW 31 [s FA 15].

(1) When seller is a cash basis person

When the seller is a cash basis person [see 470.75], the amount treated as the seller’s purchase price in s FA 15(2) is reduced by any accrued but unpaid interest on the hire purchase agreement calculated using the formula:

\[
\text{accrual income} - \text{income}
\]

Where:

“Accrual income” is the amount of income that would have been derived under one of the spreading methods for payments under the hire purchase agreement if the seller were not a cash basis person and the base price adjustment did not apply to the seller in the income year when the agreement ends.

“Income” is the amount of the seller’s income from payments received under the hire purchase agreement [s FA 16].

(2) When the buyer is a cash basis person

When the buyer is a cash basis person, the amount treated as the buyer’s sale price in s FA 15(2) is reduced by any accrued but unpaid interest on the hire purchase agreement calculated using the formula:

\[
\text{prepaid expenditure} - \text{expenditure}
\]

Where:

“Prepaid expenditure” is the amount of prepaid expenditure that would have been incurred under one of the spreading methods for payments under the hire purchase agreement if the buyer were not a cash basis person and the base price adjustment did not apply to the buyer in the income year when the agreement ends.
“Expenditure” is the amount of expenditure incurred by the buyer and treated as interest under the hire purchase agreement [s FA 17].

640.25 **Amount paid after agreement ends** [s FA 18]

When an amount payable under a hire purchase agreement is paid after the income year in which the agreement ends:

(a) If the buyer is liable to pay the amount to the seller, the amount is income of the seller under s CC 13(2);

(b) If the seller pays the amount to the buyer and, consequent on the ending of the agreement, it was not taken into account, the amount is treated as:

(i) Expenditure incurred by the seller in the income year the amount is paid; and

(ii) Income of the buyer under s CC 13(3), if they have been allowed a deduction in relation to the property in the income year the amount is paid.

For these purposes, the seller and buyer include a person associated with them.

640.30 **Applying the financial arrangement rules to hire purchase agreements**

Source: TIB vol 4:9 (May 1993) at 41, 42.

---

**Example 1:**

Assume the following facts for a hire purchase transaction:

<table>
<thead>
<tr>
<th>Vendor’s balance date:</th>
<th>31 March X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum face value of financial arrangements held by the vendor during the year:</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>(Accordingly interest income may be accrued on a straight line basis.)</td>
<td></td>
</tr>
<tr>
<td>Date of transaction:</td>
<td>5/9/X1</td>
</tr>
<tr>
<td>Cash price of the property subject to the agreement:</td>
<td>$1,000</td>
</tr>
<tr>
<td>Deposit paid by the purchaser:</td>
<td>$100</td>
</tr>
<tr>
<td>Amount loaned by way of the hire purchase agreement:</td>
<td>$900</td>
</tr>
<tr>
<td>Term of the hire purchase contract:</td>
<td>Twenty-four months</td>
</tr>
<tr>
<td>Interest rate on the loan:</td>
<td>20% pa compound, payable monthly in arrears</td>
</tr>
<tr>
<td>Hire purchase payments:</td>
<td>$45.81</td>
</tr>
</tbody>
</table>

Twenty-four equal monthly payments of $45.81 representing payment of interest and principal computed on a declining balance basis.

**Calculation of income under the agreement**

The hire purchase contract spans three tax years of the vendor. Assume the vendor adopts a 365 day basis for allocating income from the agreement. The relevant details for each tax year are:

<table>
<thead>
<tr>
<th>Year ending</th>
<th>Period of HP contract</th>
<th>Days</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/3/X2</td>
<td>5/9/X1 to 31/3/X2</td>
<td>207</td>
</tr>
<tr>
<td>31/3/X3</td>
<td>1/4/X2 to 31/3/X3</td>
<td>365</td>
</tr>
<tr>
<td>31/3/X4</td>
<td>1/4/X3 to 5/9/X3</td>
<td>158</td>
</tr>
</tbody>
</table>

Income from the agreement is spread on a straight line basis in accordance with accruals.

Determinations G1A and G24 as follows:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial deposit</td>
<td>$100</td>
</tr>
<tr>
<td>Twenty-four payments of interest and principal of $45.81 per month</td>
<td>$1,099.44</td>
</tr>
<tr>
<td>Total consideration received</td>
<td>$1,199.44</td>
</tr>
</tbody>
</table>
Hire Purchase Agreements

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less acquisition price</td>
<td>$1,000</td>
</tr>
<tr>
<td>Net income from contract</td>
<td>$199.44</td>
</tr>
</tbody>
</table>

Interest to the holder under the agreement is allocated to tax years as follows:

- Year ending 31/3/X2 (207 days) $56.55
- Year ending 31/3/X3 (365 days) $99.72

**Base price adjustment**

The base price adjustment at the termination of the contract on 5/9/X3 is calculated using the following formula:

\[ a - b + c + d \]

Where:

- \( a \) is the consideration paid or payable to the vendor less the consideration paid or payable by the vendor ($1,199.44 - $1,000 = $199.44);
- \( b \) is the total amount of income derived by the vendor from the agreement in previous tax years ($56.55 + $99.72 = $156.27);
- \( c \) is the expenditure incurred by the vendor under the agreement in previous tax years (nil); and
- \( d \) is the amount remitted by the vendor (nil).

The base price adjustment is therefore calculated as $199.44 - $156.27 + $0 + $0 = $43.17. As this is a positive amount, it will be included in the vendor’s assessable income in the 20X3-X4 tax year.

**Example 2:**

The facts are the same as in Example 1 except that income from the hire purchase agreement is calculated on a yield-to-maturity basis. (The vendor holds financial arrangements in excess of $1 million.)

- Cash price of the property subject to the agreement: $1,000
- Amount loaned by way of hire purchase agreement: $900
- Term of hire purchase agreement: Twenty-four months
- Interest payable on the loan: 20% pa compound, payable monthly in arrears

Based on this information, it is possible to construct a schedule spreading income to each tax year calculated on a yield-to-maturity basis in accordance with accruals determination G3:

<table>
<thead>
<tr>
<th>Year ending</th>
<th>Income in period</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/3/X3</td>
<td>$92.01</td>
</tr>
<tr>
<td>31/3/X4</td>
<td>$99.36</td>
</tr>
</tbody>
</table>

As before, income allocated to the year ending 31/3/X5 (the year in which the arrangement matures) is calculated using the base price adjustment:

\[ a - b + c + d \]

Where:

- \( a \) is the consideration paid or payable to the vendor less the consideration paid or payable by the vendor ($1,199.44 - $1,000 = $199.44);
- \( b \) is the total amount of income derived by the vendor from the agreement in previous tax years ($92.01 + $99.36 = $191.37);
- \( c \) is the expenditure incurred by the vendor under the agreement in previous tax years (nil); and
- \( d \) is the amount remitted by the vendor (nil).

On this basis the income attributable to the 20X4-X5 tax year under the base price adjustment is $8.07.
# Chapter 670

**Imputation**

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670.10 Overview of imputation rules

The imputation regime was introduced from 1 April 1988 to eliminate double taxation that occurred when profits of a company which had already been taxed were effectively taxed again on distribution as dividends to shareholders. The imputation system enables a resident company to pass on to its shareholders the benefit of income tax it has paid, through attaching imputation credits to shareholders’ dividends for company tax paid. A resident shareholder can then claim a credit of tax for the imputation credit attached to the dividend, against the shareholder’s income tax liability [see 670.50]. This results in company profits being effectively taxed at shareholders’ marginal personal tax rates, when those profits have been distributed to shareholders with full imputation credits attached for tax paid by the company.

For this purpose, every resident company (with the exceptions noted in 670.20), is required to maintain a memorandum account called an imputation credit account (ICA), on an annual basis from 1 April to the following 31 March (a tax year). Broadly speaking, the ICA records the company’s payments of income tax, and the allocation of the benefit of those payments to shareholders. ICA entries are in the form of credits and debits. The principal credits to the ICA are for income tax paid by the company and any imputation credits attached to dividends received by the company. The principal debits to the ICA are for refunds of tax and for the amounts of any imputation credits attached to dividends paid by the company to its shareholders [see 670.30 to 670.35].

An ICA company may determine the amount of imputation credit, if any, that it attaches to a particular dividend. However, allocation rules restrict the maximum amount of credit that can be attached, and also prevent the “streaming” or unequal allocation of imputation credits to different shareholders [see 670.45].

The ICA does not have to be in credit at the time that a debit arises for imputation credits attached to dividends. However, if the ICA has a debit balance at the 31 March tax-year end (eg if insufficient income tax has been paid in relation to imputation credits distributed to shareholders), the company must make a payment of further income tax [see 670.95]. In this situation penalties will apply [see 670.100]. The company must file an annual imputation return that gives details of credit and debit entries into its ICA [see 670.65]. The closing ICA balance for a tax year is carried forward to the following tax year [see 670.25].

Credits in a company’s ICA are lost if shareholder continuity provisions are breached. These provisions require that the company’s shareholding remains at least 66 per cent unchanged from the time that the credit to the ICA arose [see 670.75].

The imputation rules are closely linked to the foreign dividend payment (FDP) rules, that require a resident company to make a deduction of FDP from a foreign-sourced dividend received, and to pay that amount of FDP to the CIR. Like imputation credits, credits for FDP paid by the company can be attached to dividends

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paid to the company’s shareholders, and if the company does not elect to maintain a foreign dividend payment account (FDPA) the company’s payments of FDP are credited instead to its ICA [see 670.120].

The imputation and FDP rules are also linked to the branch equivalent tax account (BETA) regime, that operates to prevent double taxation arising when a resident taxpayer receives a dividend from a foreign company whose profits have been subject to New Zealand income tax, as attributed foreign income to the taxpayer, through the international tax rules. Essentially, the BETA regime allows the taxpayer to offset income tax payable on such attributed foreign income against the taxpayer’s FDP liability (or, for an individual, income tax liability) on foreign dividends received [see 670.285].

For non-resident shareholders, imputation and FDP credits attached to dividends received limit the rate of non-resident withholding tax (NRWT) otherwise applicable, and may effectively reduce NRWT liability to nil under the foreign investor tax credit regime [see 670.50, 1020.40, and 1010 NON-RESIDENT INVESTORS].

From the 1998-1999 tax year, the imputation and FDP rules also operate in conjunction with the conduit tax relief regime that provides relief from New Zealand tax when non-resident shareholders structure their investments in foreign companies through shareholdings in New Zealand companies [see 215 CONDUIT TAX RELIEF].

Various other legislative reforms have resulted in modifications to the imputation rules since their introduction. The principal reforms are set out below.

From 1 April 1990, the regime has applied to life insurance companies. Basically, these companies maintain both an ICA and a further imputation account termed a policyholder credit account (PCA) relating to notional distributions to policyholders. An outline of the operation of the PCA and its relationship to the ICA for a life insurance company is given at 800.40.

The former exemption for dividends paid between resident companies was removed from 1 April 1992 (from 30 July 1991 for certain dividends), except for dividends paid within a wholly-owned group of companies. Other changes from that date included the ability to attach imputation credits to non-cash dividends [see 670.40], and the reduction from 75 per cent to 66 per cent of the required shareholder continuity percentage for carrying forward imputation credits [see 670.75].

The attributed repatriation rules for FDP purposes were introduced from 2 July 1992 [see 670.125].

The consolidation regime for companies was introduced generally with effect from 1 April 1993. See 190.75-190.92 for an outline of the imputation, FDP, and BETA provisions that apply to companies in a consolidated group.

The BETA and FDP rules were amended from 28 September 1993, principally to permit FDP paid by a company to reduce its income tax liability on attributed foreign income. Consequential changes were made to the linkages between the ICA, FDPA, and BETA of a company [see 670.120 and 670.285].

The amalgamation regime for companies was introduced from 1 July 1994. See 180.110 for the ICA, FDPA, and BETA provisions that apply on an amalgamation of companies.

Trans-Tasman imputation was introduced with effect from the 2003-2004 tax year for the maintenance of imputation accounts by Australian companies and with effect from 1 October 2003 for the ability for an Australian company to attach imputation credits to dividends paid [see 670.375].

With the reduction in the company tax rate from 33 per cent to 30 per cent from 1 April 2008, consequential changes have been made to the imputation and FDP ratios: the maximum ratio is now 30/70. Other changes have been made to the BETA and conduit memorandum accounts and to the FITC ratios.

To ensure shareholders are not immediately affected by the new ratios, transitional rules have been introduced to allow companies to continue to allocate imputation and FDP credits at 33/67 on those earnings of the company that were taxed at 33 per cent. The transitional period is for two years, being the 2008-2009 and 2009-2010 years. However, when the 33/67 ratio is used, dividends passed up to other companies (and widely-held savings vehicles) will not get the benefit of the 33/67 ratio. That is, the credits attached will be capped at 30/70. The full 33/67 credit will flow through to the ICA.
670.15 Principal features of imputation rules

The following features apply under the imputation rules:

(a) Provisional tax or terminal tax paid by the company gives rise to credits to the imputation credit account (ICA).

(b) A refund of income tax overpaid to an ICA company is generally restricted to the credit balance in its ICA as at 31 March for the most recently ending tax year.

(c) Further income tax and a 10 per cent imputation penalty tax apply if the ICA has a debit balance at the 31 March tax-year end, or on ceasing to be an ICA company.

(d) Either imputation credits, or foreign dividend payment (FDP) credits if the company also maintains a foreign dividend payment account (FDPA), or both, can be attached to dividends paid, including non-cash dividends, subject to the allocation rules that limit the maximum amount of credits attachable.

(e) From 1 April 2008, the ratio of imputation and FDP credits to the amount of the net dividend cannot exceed 30/70. The first dividend paid in any tax year (ie the “benchmark dividend”) sets the required ratio for subsequent dividends paid for that year, unless a ratio change declaration is filed with the CIR.

(f) Special allocation rules apply for statutory producer boards and co-operative companies, which can attach credits to either cash distributions or notional distributions to members.

(g) Special imputation rules apply for qualifying companies [see 1160.68, 1160.70].

(h) Anti-avoidance rules also apply to prevent the “streaming” of credits to shareholders, including where this takes place over more than one tax year.

(i) A resident shareholder offsets imputation and FDP credits attached to dividends received against the taxpayer’s income tax liability for that year. Excess imputation credits not utilised in this way are not refundable, but in the case of a company or trustee are convertible into an amount of net loss for carrying forward to a subsequent income year, and in the case of individuals carried forward as a tax credit. Excess FDPs are refundable tax credits.

670.20 Requirement to maintain ICA [ss OA 2(2), (3), OB 1]

The ICA is a memorandum account that records a company’s tax payments and how the benefit of those payments is allocated to shareholders. Every company resident in New Zealand is required to maintain an ICA, except in certain situations. A company is not permitted to establish or maintain an ICA for any tax year, or for any period within a tax year, if:

(a) It is also resident in another country (other than Australia);

(b) It is acting in the capacity of trustee (except a company that is the trustee of a group investment fund that derives category A income. In this case the trust is taxed as a company and the trustee must maintain an ICA). Further, if a company acting in the capacity of trustee also performs other activities and is required to maintain an ICA, no debits or credits arise to the ICA for its activities as a trustee;

(c) It is prohibited by its constitution from making any kind of distribution to any shareholder of the company. This exclusion could apply to incorporated clubs and societies as the definition of shareholder includes any member;

(d) It is a company that derives only exempt income (except when that income is exempt dividend income under ss CW 9, CW 10, and CW 11, in which case an ICA must be maintained);

(e) For the purposes of a double tax agreement it is treated as being resident in a country other than New Zealand or Australia;

(f) It is a local authority;

(g) It is a Crown Research Institute;

(h) It is a portfolio tax rate entity;
It is a Maori authority.

Note: A Maori authority is required to maintain a Maori Authority credit account.

A company that is resident in both New Zealand and Australia may choose to be an Australian ICA company and elect to maintain an ICA for the purposes of the trans-Tasman imputation system [see 670.375].

670.25 Information to be recorded in the ICA [ss OA 2, OA 3, OA 7, OB 3]

Imputation is recorded and measured generally over a tax year that is from 1 April to 31 March, regardless of the company’s own balance date.

The ICA must record for each year the 1 April opening balance for that year and credits and debits to the account on the dates they are deemed to arise as per Tables O1 and O2. The opening balance of the ICA is nil for the tax year in which the company first becomes an ICA company, and for subsequent years it is the 31 March closing balance (credit or debit) for the preceding tax year.

The balance of the ICA at any time is the difference (credit or debit) between the aggregate credits and debits to the account at that time [s OA 3].

The CIR can issue a determination to correct the amount, timing, or omission of any credit or debit to the ICA that the CIR considers was recorded incorrectly or should have been recorded. The company retains the right to challenge such a determination [s 104B TAA]. Other than a determination made under this power, ICAs are not subject to annual assessment, as is the case with income tax for example. An ICA is a memorandum account and merely records credits and debits and the balances at the start and end of a tax year. As there is no assessment, there is no statute bar to the CIR adjusting entries in the ICA.

An argument could be constructed, based on the reasoning in Lloyds Bank Export Finance Ltd v Commissioner of Inland Revenue (1988) 10 NZTC 5,088 (HC). However such an argument runs contrary to the clear scheme of the ICA rules.

Records relating to the ICA must be retained for at least seven years after the end of the relevant tax year [TAA, s 22, see 670.80]. It would clearly be unreasonable for the CIR to try and adjust an ICA beyond this period if the taxpayer had disposed of the records.

670.30 Credits to the ICA [Table O1]

Table O1 sets out the credits that arise to an ICA, the date the credit arises and the section reference pertinent to the credit. The table needs to be read in conjunction with the appropriate section. For example, under row 2 of Table O1, provisional tax and income tax give rise to an imputation credit. However, the appropriate section is s OB 4, which as well as confirming that provisional and income tax paid give rise to imputation credits, it also sets out what cannot be credited.

Table O1 features in the ITA 2007 between subparts OB and OC. Each of the following transactions refers to an explanation of the imputation credits that shall be stated in the ICA, and the date when the entry should be made. For ease of reference, the row numbers are the same as those stated in Table O1 of the legislation.

1 Opening credit balance: The opening credit balance is the previous year’s closing balance if that was a credit balance. The ICA rules refresh this credit on first day of the tax year (ie 1 April irrespective of the balance date for the company) [s OA 7].

2 Provisional tax and income tax paid: To be credited on the day of payment. [s OB 4] Note that, under s OB 4(3), no credit arises for an amount that is:

(a) A transfer from a tax pooling account to the company’s tax account with the CIR [see rows 3 and 4 below and pooling of provisional tax, 1150.77];

(b) Attributable to income derived when the company was not an ICA company;

(c) Paid by a non-resident life insurance company for its policyholder base income tax liability;

(d) Paid as credits of tax for imputation credits attached to dividends received by the company in terms of ss LA 2 and LE 1. This was introduced effective from 30 July 1991 to prevent double crediting of imputation credits attached to dividends, on the removal of the intercorporate dividend exemption;
(c) Paid as credits of FDP credits attached to dividends received by the company in terms of ss LA 2 and LF 1. This provision was introduced effective from 30 July 1991 to prevent double crediting of FDP credits attached to dividends, on the removal of the inter-corporate dividend exemption;

(eb) Paid as credits for research and development expenditure in terms of ss LA 2 and LH 2;

(f) Paid by way of the company obtaining a credit of tax under the subpart LP provisions relating to supplementary dividend payments to non-resident investors [see 1010.10];

(g) Paid by way of a crediting of further income tax paid (for which an ICA credit arises), for a 31 March ICA debit balance, for which the company chooses to apply against an income tax or provisional tax liability under s OB 69;

(h) Paid for a tax liability on attributed CFC income by way of crediting the company’s BETA under s OE 7 [see 670.86]; or

(i) Paid by a company in its capacity as a trustee, unless paid on category A income of a group investment fund.

Income tax paid for the 1987-1988 and earlier income years is also excluded. [s OZ 1]

3 Deposits into a tax pooling account: An imputation credit is allowed for an amount provided by the company and paid by an intermediary into a tax pooling account. It is credited on the day the amount is deposited into the tax pooling account [s OB 5].

4 Transfer from a tax pooling account: An imputation credit is allowed for an amount that represents an entitlement to funds held in a tax pooling account and transferred by an intermediary to the company’s tax account with the Commissioner or refunded to the company. The credit date is either the date the funds held in the tax pooling account are refunded to the company, or the date that, under ss RP 19 and RP 20, the amount is transferred to the company’s tax account with the CIR [s OB 6].

5 Payment of further income tax: The credit arises on the date the further income tax (payable under ss OB 65 or OB 66 for a debit balance in the ICA as at 31 March) is paid. [see 670.95, s OB 7].

5B Payment of qualifying company election tax under s HA 40: The credit arises on the day the QCET is paid. QCET has only given rise to an imputation credit since 1 April 2008. The rationale is avoidance motivated, and designed to stop companies that are contemplating winding up from electing to become qualifying companies, paying QCET at 30 per cent on taxable reserves, and distributing those reserves tax free to 39 per cent rate shareholders. However, as QCET now gives rise to an ICA, the reserves will be fully taxable to the shareholders when distributed [s OB 7B].

5C Tax credits for research and development expenditure: An imputation credit arises for a tax credit that the company has under s LH 2. The credit arises on the date the Commissioner is notified in the company’s return of income of the entitlement to the credit. This is likely to be the date the return is filed [s OB 7C].

6 Tax withheld for resident passive income: The credit arises on the date that the deduction was made from income treated as derived by the company under s RA 9(1)(b) [s OB 8].

7 Imputation credits attached to dividends derived: A credit arises for any imputation credit attached to a dividends paid to the company. The credit arises on the date that the dividend is paid [s OB 9]. The date when a taxable bonus issue of shares with imputation credits attached is treated as having been paid will determine the date the credit arises.

8 FDP credit attached to dividend derived when not a FDPA company: FDP credits attached to dividends paid to the company give rise to ICA credits if the company is not a FDPA company at the time of receipt of the dividend. The credit arises on the date the dividend is paid [s OB 10].

9 Payment of FDP when not an FDPA company: A credit arises for an amount of any FDP paid by the company when it is not an FDPA company on the date the FDP is paid. No credit arises for the offset of a FDP liability against income tax losses under s RG 6 [s OB 11].
Transfer from FDP account: A credit arises for an amount equal to the amount of FDP debit transferred from its FDP account under s OC 18 [s OB 12]. The company may wish to do this to cover an ICA debit balance [see 670.165]. The credit to the ICA and corresponding FDP debit arise at the end of the relevant tax year under s OC 18(6). Note that s OB 12 states the credit arises on the date of transfer. However, this is not consistent with the ITA 2004 which provides the credit arises at the end of the tax year in which the FDP debit arose.

Transfer of debit balance when company leaves wholly-owned group: This was introduced together with provisions aimed at imputation credit shopping [see 670.70 and s OB 71]. A company with a debit balance in its ICA that leaves a group that has a loss balance carried forward in excess of $1,000,000, may elect that an amount (not more than the debit balance) be a debit in the ICA of a company [s OB 44] that remains a member of the wholly-owned group that the company concerned left. The debit will give rise to this corresponding credit. The credit arises on the day the company stops being a part of the wholly-owned group [s OB 13].

Additional tax payable when company leaves a wholly-owned group: The imputation additional tax that is paid under s OB 71(6) gives rise to an ICA credit on the date of payment. This provision is also to prevent imputation credit shopping [see 670.70 and ss OB 14, OB 71].

Additional income tax when company joins wholly-owned group: The imputation additional tax that is paid under s OB 72(7) gives rise to an ICA credit on the date of payment. This provision is also to prevent imputation credit shopping [ss OB 15, OB 72].

Attribution of personal services if company is not a qualifying company: An ICA arises on 31 March for an amount equal to 42.86 per cent of the amount attributed under s GB 29 (the attribution rules) [see 740.33]. No credit arises if the company is a qualifying company [s OB 16].

Transfer from PCA: A credit arises on the day the amount is transferred [see 800.50] equal to the amount of the debit under s OJ 9 for the transfer of a credit from the PCA to the ICA [s OB 17].

Transfer from available subscribed capital (ASC) account: A credit arises for the transfer from the ASC account under subpart OF on the date of transfer [s OB 18]. The ASC rules were introduced to overcome “negative dividend” issues arising in the managed funds industry.

Transfer to master fund: A credit arises on 31 March for the transfer of an amount to a master fund equal to 30 per cent of the amount of expenditure transferred in accordance with ss DV 5 to DV 7 [s OB 19].

Maori authority credit attached to distribution received by company: A credit arises on the day the distribution is paid for the amount of a Maori authority credit attached to a distribution received [s OB 20].

Transfer of balance of Maori authority tax credit: A credit arises when a company ceases maintaining a Maori authority credit account for the amount of the credit balance in the Maori authority credit account. The credit arises on the date on which the account is closed [s OB 21].

Replacement money paid under a share-lending arrangement: A credit arises for an imputation credit attached under s OB 64 to a replacement payment made by a share user under a share-lending arrangement, or treated as attached under s RE 25 to a replacement payment paid to the company under a share-lending arrangement [see 1340.90]. The credit arises on the date the replacement payment is made [s OB 22].

Imputation credit shown in credit transfer notice: A credit arises on the date the notice is given for the amount of an imputation credit shown in a credit transfer notice given to the company [see 1340.90, s OB 23].

Imputation credit, FDP credit, or policy holder credit on resident’s restricted amalgamation: A credit arises on or after a resident’s restricted amalgamation in the ICA of an amalgamated company when ss OA 10 to OA 17 apply [s OB 24].
Reversal of debit for tax advantage arrangement: A credit arises for the amount of a debit in the company’s ICA under s OB 54 (which relates to debits arising for imputation credits determined to have been subject to an arrangement to obtain a tax advantage arrangement) when it is established that an imputation credit in a company’s ICA was incorrectly determined to be the subject of an arrangement to obtain a tax advantage [see 670.115]. The credit arises on the date the debit was made under s OB 54 [s OB 25].

Eliminating debit for loss of shareholder continuity cancelling tax pooling account deposit that is refunded or credited: This credit arises to eliminate what would otherwise be a double debit when there is a shareholder continuity debit under s OB 41, and after the shareholder continuity debit, a further debit arises under s OB 34 for a refund of an amount by an intermediary from a tax pooling account or the deposit is transferred to the tax account of the taxpayer a client of the tax pooling intermediary under s RP 19. The double debit is eliminated by crediting the ICA with a credit equal to the amount of the shareholder continuity debit. The credit arises on the day the deposit is refunded, or when the credit for the tax transferred from the tax pool arises in the company’s ICA [s OB 26].

Amount of tax withheld from Australian ICA company for non-resident passive income: An Australian ICA company has an imputation credit for an amount of tax withheld by the payer of the non-resident passive income. The credit arises on the date that the tax is withheld [s OB 27].

Amount of tax withheld from schedular payment to Australian ICA company: An Australian ICA company has an imputation credit for an amount of tax payable on a scheduler payment paid to the company as a non-resident contractor. The credit arises on the date that the tax is withheld [s OB 28].

Schedular income tax paid by Australian ICA company: An Australian ICA company has an imputation credit for a payment of income tax relating to the company’s schedular income tax liability for income arising under ss CR 3, CV 16 and CV 17 (which relate to non-resident insurers, shipper and film renters respectively). The credit arises on the date the schedular income tax is paid [s OB 29].

Note: A provision existed in s ME 4(1)(b) of the ITA 2004 to ensure imputation credits arose for overpaid provisional tax by another company in the same wholly-owned group of companies that the other company has elected, under s RC 32, to allocate to the company to cover its underpaid provisional tax. This provision seems to have been missed from the ITA 2007.

Debits to the ICA [Table O2]

Table O2, like Table O1, features in the ITA 2007 between subparts OB and OC and follows Table O1. Each of the following transactions refers to an explanation of the imputation debits that shall be stated in the ICA, and the date when the entry should be made. The row numbers are the same as those stated in Table O2 of the legislation.

1. **Opening debit balance**: The opening debit balance is the previous year’s closing balance if that was a debit balance. The ICA rules refresh this debit on first day of the tax year (ie 1 April irrespective of the balance date for the company) [s OA 7].

2. **Imputation credit attached to dividend paid**: A debit arises for the amount of imputation credit attached to a dividend paid by the company. The debit arises on the date the dividend is paid [s OB 30].

3. **Allocation of provisional tax**: A debit arises for any provisional tax that the company has overpaid and then elects, under s RC 32 to allocate to another company in the same wholly-owned group of companies, to cover the latter company’s underpaid provisional tax. The debit arises on the date that notice in writing of the allocation is supplied to the CIR [s OB 31].

4. **Refund of income tax**: A debit arises for income tax refunded to the company (for tax paid as from 1988-1989), except to the extent that:
(a) The tax paid was for an income year when the company was not an ICA company (with apportionment applying where it was an ICA company for part of a year); or

(b) A debit has already arisen in the ICA through a breach of shareholder continuity requirements after the original date that the tax was paid. This is to prevent double debiting of the ICA for the same amount of tax paid. If, however, the refund arises under the provisions of paying supplementary dividends to non-resident investors, then the supplementary dividend must have been paid before the debit for the breach of shareholding continuity arose. This ensures that no double debit to the ICA will occur when there is a breach of shareholder continuity between the payment of a supplementary dividend and the receipt by the company of a related refund of foreign investor tax credit.

The debit to the ICA for tax refunded arises on the date the refund is paid [s OB 32].

5 Overpaid income tax applied to meet another tax liability: A debit arises for overpaid income tax that the CIR applies to satisfy some other tax liability of the company (ie GST). If there has subsequently been a breach of shareholder continuity that has given rise to an ICA debit, then the debit is limited to the amount that overpayment applied to the other tax liability exceeds the loss of continuity ICA debit (thus preventing double debiting). The debit arises on the date that the amount is applied [s OB 33].

6 Refund from tax pooling account: A debit arises where there is a refund of an amount held by an intermediary from funds in a tax pooling account for which the company has received an imputation credit. The debit arises on the day the refund is made [s OB 34].

7 Transfer of entitlement to another person in tax pooling account: A debit arises where there is a transfer of an amount held by an intermediary from funds in a tax pooling account for which the company has received an imputation credit. Where the refund is for a qualifying company, the debit arises on the date of the refund. In all other cases the debit arises:

(a) On the last day of the previous tax year to the extent to which the debit does not exceed the credit balance of the account on that day;

(b) On the date on which the refund is made to the extent to which it exceeds the amount in item (a) above, but does not exceed the credit balance of the account on that day;

(c) On the last day of the previous tax year for the remainder of the debit [s OB 35].

8 Refund of FDP when not FDPA company: A debit arises for a refund of a FDP paid to the company at a time when it does not maintain a foreign dividend payment account. The debit arises on the date the refund is paid [s OB 36].

9 Refund of tax credit: The debit arises on the day of the refund [s OB 37].

10 Overpaid FDP applied to satisfy liability when not FDPA company: A debit arises when overpaid FDP is applied to pay amounts due under the Inland Revenue Acts when the company does not maintain a FDPA. The debit arises on the date the amount is applied [s OB 38].

11 Overpaid income tax or FDP applied to satisfy pre-imputation income tax when not an FDPA company: The debit arises on the day of application [s OZ 3].

12 Transfer to FDP account on account of net foreign attributed income for income year: Transfer to FDP account on account of net foreign attributed income for income year A debit arises under the CTR rules [see 215.10] if the company maintains a FDPA for an amount that is transferred to the FDPA on account of its income tax liability on any foreign attributed income for its income year that corresponds with the tax year. The amount transferred to the FDPA depends on whether the company is also a CTR company for the corresponding tax year. The company must apply either of two methods in order to calculate the amount to be transferred. If neither method can be applied, then no transfer arises under these provisions. Method 1 applies when the company is an FDPA company and a CTR company for all of the tax year. Under this method, the company must apply ss LQ 1 to LQ 4 (which relate to credits for conduit tax relief) as if:
(a) The amount transferred were CTR for the tax year;
(b) The percentage of resident shareholders were substituted for the item percentage of shareholders in s LQ 1 and LQ 2(2); and
(c) The percentage of resident shareholders were calculated by subtracting the item percentage of shareholders from 100 per cent.

Method 2 applies when the company is not both a FDPA company and a CTR company for all of the tax year. Under this method the company must make the calculation under ss LQ 1 and LQ 2 as if the company were a CTR company and the item percentage of shareholders were 100 per cent. The debit to the ICA arises on the last day of that tax year, to the extent that it does not exceed the amount of provisional tax paid prior to 31 March tax-year end for that income year. Any excess above that amount is debited to the ICA on the date that the company files its income tax return for that income year [s OB 39].

13 Attribution for personal service: A debit arises for the amount of a credit arising under s OB 16 if the company’s financial statements are adjusted to reflect an amount attributed in accordance with s GB 29 [see 740.33, s OB 40]. The debit arises on 31 March.

14 Debit for loss of shareholder continuity: Any credits existing in the ICA (and not cancelled by a prior or subsequent debit) at any time where there is a breach of shareholder continuity [see 670.75]. The debit occurs at the time the breach of shareholder continuity occurs [s OB 41].

15 Debit for on-market cancellation: A debit arises where the company repurchases its shares in an on-market acquisition [see 270.35], and the distribution to the shareholder exceeds the available subscribed capital per share cancelled. The debit is calculated by applying the tax rate applicable to dividends (on a “grossed up” basis) to the amount of the excess distribution. The formula is:

\[ \text{ASC per share excess} \times \frac{\text{tax rate}}{1 - \text{tax rate}} \]

Where:

“ASC per share excess” is the amount distributed on the on-market cancellation that is more than the amount of the available subscribed capital per share calculated under the ordering rule.

“Tax rate” is the basic rate of income tax for companies for the tax year in which the acquisition occurs.

The debit arises on the date that the share acquisition occurs.

Note: A deemed on-market acquisition by the company will arise where shares are acquired by an associated person of the company, under an arrangement for that associated person to acquire the shares in lieu of the company. There is a requirement that the acquisition would have been an on-market transaction if the company had been the acquirer [s OB 42].

16 Debit for breach of imputation ratio: An allocation debit arises when the imputation ratio of a subsequent dividend differs from that of the benchmark dividend [see 670.45]. The debit arises at the end of the tax year for which the allocation debit arises [s OB 43].

17 Transfer for debit balance when company leaves wholly-owned group: Day on which company leaves group [s OB 44].

18 Redemption debit for unit trust or group investment fund for income year: A special imputation debit may arise to the ICA of a unit trust manager or the trustee or manager of a group investment fund (GIF). The debit arises where this manager or trustee derives a dividend on redeeming units purchased from investors in the ordinary course of the activities. The debit is effectively an amount equal to the greater of the total imputation and FDP credits attached to the dividend or the amount of income tax liability of the manager or trustee that is attributable to the dividend. The provision also applies for a consolidated group of which the manager is a member [see TIB vol 7:9 (February 1996) at 7, s OB 45].

19 Transfer from member fund to master fund: A debit arises for expenditure transferred by the company, being a member fund, to a master fund under ss DV 5 to DV 7. The debit is calculated as the amount
of expenditure transferred multiplied by the company tax rate and arises on 31 March corresponding to the income year in which the expenditure is transferred [s OB 46].

Transfer to company’s PCA: A debit arises for the amount of the credit balance in a life insurance company’s ICA that the company elects to credit to its PCA. The debit to the ICA and credit to the PCA arise on the date that the company elects by recording the entries in these memorandum accounts [s OB 47].

Credit balance when Maori authority credit account starts: A debit arises equal to the amount of the credit balance of the ICA if, during the tax year, the company establishes a Maori authority credit account. The debit arises immediately before the company becomes a Maori authority [s OB 48].

Credit attached to replacement payment paid by company under share-lending arrangement: A debit arises for the amount of an imputation debit attached under s OB 64 to a replacement under a share-lending arrangement. The debit arises on the day of payment [s OB 49].

Credit attached to dividend paid to company shown in returning share transfer: A debit arises for the amount attached to a dividend that is paid to the company as a share user in a returning share transfer that is not a share-lending arrangement. The debit arises on the day of payment [s OB 50].

Credit attached to dividend paid to company shown in credit transfer notice: A debit arises for the amount attached to a dividend that is paid to the company if the credit is shown in a credit transfer notice issued by the company. The debit arises on the day the dividend is paid [s OB 51].

Credit that is also credit to ICA of consolidated imputation group: Credit date for imputation credit [s OB 52].

Imputation debit, FDP debit, or policyholder debit in account of amalgamating company: Debit date in account of amalgamating company [s OB 53].

Debit for tax advantage arrangement: A debit may be imposed where under the anti-avoidance provision of s GB 36 there is an arrangement to obtain a tax advantage [see 670.115]. The debit arises at the end of the tax year in which the tax advantage arrangement occurred or commenced [s OB 54].

Retrospective attachment of imputation credit to non-cash dividend: Day of payment of dividend [s OB 55].

Final balance when ICA company status ends: A debit arises for any credit balance in the ICA when the company ceases to be an ICA company (eg on ceasing to meet the residency requirements, or on winding up). The debit arises immediately before the company ceases to be an ICA company, so that any credit balance in the ICA is extinguished at that time [s OB 56].

Refund of amount of tax for non-resident passive income to Australian ICA company: Day of refund [s OB 57].

Refund of amount of tax for schedular payment to Australian ICA company: Day of refund [s OB 58].

Refund of schedular income tax to Australian ICA company: Day of refund [s OB 59].

670.40 Attaching imputation credits to dividends [ss OB 60, OB 61, OB 62, OB 63, OB 64]

An imputation credit account (ICA) company is authorised to attach an imputation credit to a dividend, should it choose to do so, on payment of the dividend [s OB 60]. If it does so, the total of the dividend paid plus the attached imputation credit will be included in the income of the shareholder [see 670.50]. The company is free to determine the amount of imputation credit attached, provided the allocation rules as to maximum permissible credits and benchmark dividends are adhered to [see 670.45].

As the company must attach the imputation credit at the time the dividend is paid, it is suggested that a statement to this effect should be included in the company’s resolution to pay the dividend.
An exception to this timing rule, is that imputation credits can be attached retrospectively to a non-cash dividend in circumstances where the arrangement giving rise to that dividend has been subject to a transfer pricing adjustment [see 1000.70] under s GC 7. If the company does so, the debit to the ICA arises on the date of payment of the non-cash dividend. The maximum amount of retrospective credit attachments is limited, in that the aggregate imputation credits so debited must not cause an ICA debit balance to arise at 31 March in any tax year from the year of payment of the dividend up to the year immediately prior to that in which the retrospective attachment is made. However, when extra income tax is paid by the company as a result of the transfer pricing adjustment, the company can also utilise part or all of that extra income tax (on written notification to the CIR) to retrospectively attach imputation credits to the prior year’s non-cash dividend. In this case, that income tax is treated for ICA purposes as having been paid at the time of the non-cash dividend [s OB 62]. TIB vol 7:11 (March 1996) at 9 contains a practical example of this rule. For the compliance procedures regarding the preparation of company and shareholder dividend statements and notification to the CIR, see 670.60.

Imputation credits may also be attached retrospectively where the company is emigrating and is treated as having made a distribution to its shareholders [see 170.65]. Tax paid that is attributable to the deemed disposal of property is treated as being paid immediately before migration thereby making it available for attaching to the deemed distribution to shareholders.

The ICA does not have to be in credit at the time a debit arises for imputation credits attached to dividends. This means the company can anticipate payments of provisional tax or income tax that will be made after that date. However, if a debit balance remains at the 31 March end of the tax year, further income tax [see 670.95] and penalties [see 670.100] will apply.

Any dividend that arises for income tax purposes (subject to the non-cash dividend rules noted below) can have imputation credits attached to it at the time it is paid (or deemed to be paid). However, exceptions exist for any dividend that is:

(a) Deemed to arise under s GB 23 from excessive remuneration paid by a company to a relative of a director or shareholder;
(b) Deemed to arise under s GB 25 from excessive remuneration paid by a close company to a shareholder or director or relative of any such person; or
(c) Deemed to arise under the proviso to s CB 34 when a mutual association pays a rebate in excess of the amount for which a deduction is allowed.

(1) **Non-cash dividends**

Non-cash benefits provided to shareholders who are also employees of the company are generally excluded from being dividends and subject instead to fringe benefit tax (FBT) [ss CD 32, CX 17]. However, s CD 20 provides for the employer company to elect, by notice in writing to the CIR within the time allowed for filing the FBT return, that benefits falling within “unclassified benefit” under s CX 37 will be treated instead as being a dividend.

Accordingly, imputation credits may be able to be attached to both cash and non-cash dividends generally. The rules for determining the amount of non-cash dividends, and the time at which they arise for imputation credit attachment purposes, are set out in s CD 39 [see 270 DIVIDENDS].

### 670.45 Allocation rules and benchmark dividend

[ss OA 18, OB 43, OB 61]

(1) **Allocation rules**

There are two allocation rules to prevent imputation credits from being directed to shareholders on an inappropriate basis. They place restrictions on the imputation ratio of a dividend (ie the ratio of the amount of attached imputation credit to the amount of dividend paid — exclusive of the imputation credit or any foreign dividend payment (FDP) credit).

The first allocation rule restricts the maximum amount of imputation credit that can be attached. It requires that the imputation ratio of the dividend cannot exceed the following fraction:
tax rate / (1 – tax rate)
Where “tax rate” is the basic rate of income tax for companies, expressed as a percentage, for the income year.
Therefore, the maximum imputation ratio is 30/70 or approximately 42.86 per cent.
This rule prevents imputation credits from being attached to dividends in excess of the maximum income tax payable on the dividends.

Example:
A company resolves to pay a dividend of $700 and to attach an imputation credit. The maximum imputation credit that can be attached is $300, calculated as 30/70 × $700, and doing so would result in a total distribution for tax purposes of $700 + $300 = $1,000 to the shareholders. However, the company could instead attach any amount of imputation credit, not exceeding $330 under the transitional rules that applied when the tax rate was dropped to 30 per cent. The transitional rules allowed old 33 per cent imputation credits to be used until 31 March 2010.

Where the imputation ratio of a dividend exceeds the 30/70 maximum, the excess amount of imputation credits attached is not allowed as a credit of tax and is excluded from the amount of dividend derived [see 670.55]. However, the full amount of imputation credits attached is still debited to the company’s imputation credit account (ICA), so that the excess amount is effectively forfeited.

The second allocation rule is aimed at preventing the “streaming” or unequal allocation of imputation credits to different shareholders or different classes of shareholders (not all of whom may be able to utilise the tax credits) during a tax year. It requires that the imputation ratio of every subsequent dividend paid by the company during a tax year must be the same as the imputation ratio of the “benchmark dividend”, unless the company has supplied a ratio change declaration, in the prescribed form, to the CIR.

(2) Benchmark dividend
The benchmark dividend for a tax year is the first dividend paid by the company in that tax year. If the company becomes an ICA company during a tax year, it is the first dividend paid while the company is an ICA company [s OB 61(3)].
If the imputation ratio of the benchmark dividend exceeds the maximum permissible figure in breach of the first allocation rule above, the benchmark dividend’s ratio for the purposes of the second allocation rule is deemed to be the maximum permissible (ie 30/70).
The imputation ratio of a dividend paid subsequent to the benchmark dividend in a tax year can differ from that of the benchmark dividend if:
(a) A ratio change declaration is filed with Inland Revenue before the date of payment of the subsequent dividend, or before such later date as the CIR may allow; and
(b) The subsequent dividend is not paid as part of an arrangement to obtain a tax advantage [see 670.115].
The ratio change declaration requires an officer of the company to declare, in the prescribed form, that the subsequent dividend is not being paid as part of an arrangement to obtain a tax advantage, and to provide such further information as is prescribed.

Note: Any non-cash dividends paid will have benchmark dividend implications [see 670.40]. These are generally deemed to be paid to the shareholder once a year on the earlier of six months after the end of the company’s income year or the date of any notification to the shareholder of the amount of the dividend [see 270 DIVIDENDS].

(3) Allocation debit
If the second allocation rule is breached (ie where the required ratio change declaration is not filed, or the subsequent dividend paid is part of an arrangement to obtain a tax advantage), an allocation debit arises to the ICA, calculated as follows:

\[(\text{net dividends} \times \text{imputation ration}) - \text{attached credits}\]

Where:
“Net dividends” is the total of all dividends paid during the tax year exclusive of any imputation credits or FDP credits attached;

“Imputation ratio” is the maximum permitted ratio calculation (as above) not exceeding 30/70 or if less, the greatest imputation ratio of dividends paid by the company for the tax year;

“Attached credits” is the total of all imputation credits attached to dividends paid during the tax year.

The allocation debit is effectively the difference between the total amount of imputation credits actually attached to dividends paid during the income year, and the total amount of imputation credits that would have been attached if all such dividends had imputation ratios equal to the highest imputation ratio (not exceeding 30/70) that was actually adopted.

Example:
An ICA company pays the following dividends:

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
<th>Imputation Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>9 July</td>
<td>$10,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>9 January</td>
<td>$10,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>15 March</td>
<td>$20,000</td>
<td>$7,760</td>
</tr>
</tbody>
</table>

The imputation ratio (7,760/20,000, or 38.8 per cent) of the subsequent 15 March dividend differs from that of the 9 July benchmark dividend. No ratio change declaration was filed. The allocation debit arising is: $(40,000 \times 0.388) - $13,760 = $1,760.

The allocation debit to the ICA rises at 31 March year end, so that it might cause an ICA debit year end balance to arise with consequential further income tax and penalties [see 670.95].

These allocation rules do not apply to statutory producer boards and co-operative companies [see 670.85 and 670.90].

(4) Modifications to the allocation rules

The first allocation rule is modified when the company maintains both an ICA and a foreign dividend payment account (FDPA), and attaches both imputation credits and FDP credits to dividends paid. In this case, the rule is that the combined imputation and FDP ratio of the dividend cannot exceed 30/70 [see 670.175].

The allocation rules are also further modified in the case of a conduit tax relief (CTR) company [see 670.175].

Special allocation rules apply to qualifying companies. Under s HA 15 qualifying companies are generally required to attach imputation or FDP credits to dividends to the maximum extent possible [see 1160.70].

670.50 Shareholder income and tax credits [ss CD 15, LE 10, LE 11, OC 1(5); TAA, s 78D]

As a general rule, the amount of dividend included in income derived by a resident taxpayer includes not only the amount of dividend paid, but also the amount of any imputation credit (or foreign dividend payment (FDP) credit [see 670.180] attached to the dividend [s CD 15]. The taxpayer is entitled to a credit of tax for the amount of imputation credit included in income [s LE 1]. However, this general rule is modified by the various provisions, which limit in particular circumstances the amount of imputation credit that applies for both income and tax credit purposes [see 670.55].

To obtain the tax credit, the taxpayer may furnish the shareholder dividend statement [see 670.60] or other written evidence of the imputation credit [s LE 11; TAA, s 78D]. However, Inland Revenue does not require the statement to be supplied unless there is doubt about the credit claimed. The tax credit is credited against the income tax liability of the resident taxpayer for that income year, so that any amount of imputation credit in excess of the tax liability on the dividend (eg for an individual taxpayer) is effectively offset against the tax liability on the taxpayer’s other income.

Where the taxpayer is a company (as defined in s YA 1), a trustee (other than the Maori Trustee), a Maori Authority or where the dividend is Category A income of a group investment fund, any surplus tax credit is not refundable [s IA 2(4)(a)], but instead is converted into a tax loss that is available:
Imputation

(a) To be carried forward as an available net loss to a later income year (subject, if the taxpayer is a company, to the continuity provisions that apply to changes in company shareholding); or

(b) If the taxpayer is a company, to be offset against the net income in the same income year of another company in the same group of companies (provided the requirements for grouping of losses are met [see 940 LOSSES].

The amount of the deemed net loss is calculated by dividing the amount of surplus tax credit by a percentage, depending on the nature of the taxpayer, as follows:

(a) The basic rate of income tax for companies, where the taxpayer is a company; or

(b) The rate of tax applicable to category A income of a group investment fund (GIF), for category A income of a group investment fund;

(c) The basic rate of income tax for trustees, where the taxpayer is a trustee other than the Maori Trustee; or

(d) The basic rate of income tax for Maori authorities, where the taxpayer is a Maori authority.

The above loss conversion rates are contained in sch 1, Part A [see 1190.20, 1190.30, 1190.35].

Where the taxpayer is an individual or incorporated body, any excess imputation credits received in the 2005-2006 and later income years are carried forward to the next income year. Credits received in income years prior to the 2005-2006 income year were converted to a loss by dividing the excess credit by 21 per cent.

No claim for a credit of tax [s LE 10] is allowed where:

(a) It would be inappropriate for the credit to be allowed, in whole or in part, because the company that issued the imputation credit has paid insufficient income tax or further income tax for it. In this case, the claim for the tax credit is disallowed to the extent that the CIR considers appropriate. However, the disallowance is to be reversed where sufficient income tax or further income tax has subsequently been paid by the company.

(b) The CIR is satisfied that the credit of tax claimed exceeds the proper amount (eg if it has been miscalculated, or exceeds the maximum imputation credit permissible), in which case the excess amount claimed is not allowed.

Where a credit of tax has been allowed by the CIR in excess of the proper amount, the CIR can recover the amount of excess as if it were income tax payable by the taxpayer [TAA, s 165A].

Credits of tax for imputation credits attached to dividends are limited to such imputation credits arising under the New Zealand imputation regime for companies, and so do not apply to dividends from Australian companies with imputation credits attached under Australia’s imputation regime [see 760 INCOME FROM NEW ZEALAND AND FOREIGN SOURCES], for the implications of such dividends and credits for foreign taxes paid.

However, imputation credits attached to dividends from Australian companies under the trans-Tasman triangular rules [see 670.375] are allowed as credits in New Zealand. If the interest in the Australian company is an attributing interest in a FIF, the imputation credit is treated as assessable income for the purposes of determining the taxpayer’s entitlement to the credit, despite the fact that under s EX 59 the dividend to which the credit is attached is assessed under the FIF rules and not assessed separately. In other words, the dividend is treated as separately assessable for determining the taxpayers eligibility to the credit.

For a non-resident taxpayer, imputation credits attached to dividends paid limit the rate of non-resident withholding tax (NRWT) otherwise applicable (subject to the operation of the provisions of any double tax agreement), or eliminate NRWT liability in the case of fully imputed non-cash dividends [see 1020.42]. See 1010 NON-RESIDENT INVESTORS for the subpart LP foreign investor tax credit provisions that apply to non-resident investors.
670.55  **Limits on amount of shareholder tax credit** [ss LE 4, LE 5, LE 6, LF 2, LF 3, LF 4]

Various rules determine or limit, in particular circumstances, the amount of imputation credit or foreign dividend payment (FDP) credit that is treated as being attached to a dividend. Where these provisions apply, the amount so calculated is substituted for the actual amount of imputation credit attached, in determining the amount of the dividend to be included as income and the imputation or FDP tax credits available.

(1) **Beneficiaries of trusts**

Trust beneficiaries who derive, as beneficiary income, dividends with imputation credits attached (except for category A income from a group investment fund), have the amount of imputation credit calculated under the following formula:

\[
\text{(person’s distributions / trust distributions)} \times \text{total beneficiary credits} - \text{person’s supplementary dividend}
\]

Where:

“Person’s distributions” is the total of all distributions (whether income or capital, and whether or not assessable to the beneficiary) made to the beneficiary in the income year;

“Trust distributions” is the total of all distributions as above made to all beneficiaries of the trust in the income year (including supplementary dividends);

“Total beneficiary credits” is the total of all imputation credits attached to all dividends and total supplementary dividends paid to beneficiaries in the income year;

“Person’s supplementary dividend” is the total supplementary dividends for the tax year paid to the person in their capacity as beneficiary of the trust.

The formula effectively pro-rates total imputation credits attached to dividends paid to beneficiaries, according to each beneficiary’s share of any distributions from the trust in that income year. All types of distribution are to be taken into account for this purpose. A similar formula pro-rates FDP credits. The rule is aimed at preventing the “streaming” of dividends with credits attached to beneficiaries best placed to utilise those credits (eg New Zealand residents as opposed to non-residents).

**Note:** The formula does not apply to a beneficiary who derives dividends from the trust that do not have either imputation credits or FDP credits attached. However, distributions to that beneficiary are to be taken into account in the calculation of “trust distributions” in the above formula, when applying the formula to other beneficiaries.

The application of the formula can reduce the total amount of imputation or FDP credits allocated to beneficiaries for income tax purposes, as shown in the example below.

**Example:**

During the income year, a trust makes the following distributions:

(a) To beneficiary A: dividends of $15,000 with $4,500 of imputation credits attached
(b) To beneficiary B: capital of $4,000, and dividends of $6,000 with $1,800 of imputation credits attached
(c) To beneficiary C: capital of $5,000.

The total of all distributions made is $30,000, and the total of all imputation credits attached to dividends distributed is $6,300.

The amounts of imputation credit to be included in income and credits of tax available for each beneficiary, applying the formula above, are as follows:

<table>
<thead>
<tr>
<th>Beneficiary</th>
<th>Formula</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>15,000/30,000 × 6,300</td>
<td>$3,150</td>
</tr>
<tr>
<td>B</td>
<td>10,000/30,000 × 6,300</td>
<td>$2,100</td>
</tr>
<tr>
<td>C</td>
<td>Nil</td>
<td></td>
</tr>
</tbody>
</table>

Accordingly an amount of $1,050 of total imputation credits attached to the dividends is effectively lost.

The formula above is modified where a non-resident beneficiary receives from the trust a supplementary dividend under the foreign investor tax credit provisions of subpart LP [see 1010.30]. In such a case, the “total beneficiary credits” in the formula includes the amount of all supplementary dividends distributed from...
the trust to beneficiaries during the income year. The amount of imputation credit calculated for each such non-resident beneficiary is then reduced by the amount of the supplementary dividend.

In certain circumstances, a distribution to a beneficiary who is a minor is treated as taxable to the trustee rather than to the minor [see 1420.60]. Where this is the case, any credit allocated to the minor as a result of the above formula is deemed to be income of, and allowable as a credit to, the trustee.

(2) **Partners**

The amount of imputation credit for a partner of a partnership who, as a partner, derives dividends with imputation credits attached, is calculated under the following formula:

\[
\text{Partner's income / partnership income} \times \text{partnership imputation credits} - \text{partner's supplementary dividend}
\]

Where:

- “Partner’s income” is the total assessable income of the partner from the partnership for the income year excluding the imputation and FDP credits (and also excluding any supplementary dividend if the partner is a non-resident);
- “Partnership income” is the total assessable income of the partnership for the income year excluding the imputation and FDP credits and any supplementary dividends;
- “Partnership imputation credits” is the total of all imputation and supplementary credits attached to dividends derived by all partners of the partnership in the income year;
- “Partner’s supplementary dividend” is the total supplementary dividends for the tax year derived by the person as a non-resident partner.

This formula also effectively pro-rates credits among partners according to each partner’s share of partnership income. Non-resident partners have the credits allocated to them reduced under this formula by the amount of supplementary dividends derived. A similar formula is used to pro-rate the FDP credits derived by a partnership.

(3) **Other rules**

Other rules limiting the credits are as follows:

(a) If a dividend has an imputation ratio greater than the 30/70 maximum permitted, the imputation credit is limited to the maximum permissible amount [see 670.45];

(b) If a dividend has a FDP ratio [see 670.175] greater than the 33/67 maximum permitted, the FDP credit is limited to the maximum permissible amount;

(c) If a dividend has a combined imputation and FDP ratio greater than the 30/70 maximum permitted, the amounts of the imputation and FDP credits are reduced in the following way. The FDP credit is first reduced, as far as it extends, by the amount of the excess credit amount [see 670.175]. If there is still any remaining excess credit amount, the imputation credit is correspondingly reduced. This rule means that (potentially refundable) FDP credits are lost first;

(d) If the CIR has not fully allowed an imputation credit or a dividend withholding credit because a shareholder dividend statement or other written evidence has not been provided, or because the CIR considers that insufficient income tax or further income tax supporting the credit has been paid by the company, or that the credit claimed exceeds the proper amount, the amounts of each of these credits are the amounts (if any) allowed by the CIR;

(e) Where the dividend arises from a “stapled stock” arrangement subject to the anti-avoidance provision s GB 37 [see 670.110], the amount of any imputation credit attached is nil;

(f) Where an imputation credit or FDP credit arises under an arrangement that the CIR determines is an arrangement to obtain a tax advantage subject to the anti-avoidance provision ss GB 35, GB 36; TAA, s 90AF [see 670.115], the amount of the credit is the amount (if any) that remains after the CIR has made a determination reducing the credit by the amount that the CIR considers is the subject of the arrangement.
670.60  **Dividend statements** [TAA, ss 29, 30, 67, 68]

(1)  **Shareholder dividend statement**

A company that pays a dividend with an imputation credit or foreign dividend payment (FDP) credit or conduit tax relief (CTR) credit attached (or from which resident withholding tax (RWT) has been deducted) must, at the time of payment, give the shareholder a statement in a form approved by the CIR which shows:

(a)  The name of the company;

(b)  The date of payment of the dividend;

(c)  The name and address of the shareholder;

(d)  The amount, if any, of RWT deducted;

(e)  The amount, if any, of non-resident withholding tax (NRWT) deducted;

(f)  The amount of dividend actually paid;

(g)  The amount of any imputation credit attached;

(h)  The aggregate of the dividend paid and imputation credit attached;

(i)  If a FDP credit is attached to the dividend:

  (i)  The amount of the FDP credit;

  (ii) The aggregate of the dividend paid and the sum of the imputation and FDP credits;

  (iii) The aggregate of the imputation and FDP credits; and

(j)  Such other information as the CIR may require.

If a CTR credit [see 215.65] is attached to the dividend, the statement must also include [TAA, s 30A]:

(a)  The amount of the CTR credit;

(b)  The amount of the s LQ 5 additional dividend [see 215.30]; and

(c)  The aggregate of the dividend paid and the CTR additional dividend paid.

Where a company has emigrated and is deemed under subpart FL to have made a distribution to shareholders [see 170.65], the statement must be provided to shareholders within three months following the date of migration.

The statement is deemed to have been given to the shareholder when it is given personally to either the shareholder or a person authorised to act on the shareholder’s behalf, or posted to the usual or last known place of abode or business of the shareholder or that authorised person.

(2)  **Company dividend statement**

At the time that it declares a dividend (whether or not imputation or FDP credits are to be attached), an ICA company must complete and retain a company dividend statement, in a form approved by the CIR, which shows:

(a)  The number of shares for which the dividend is declared (or, if it is a bonus issue, included in the bonus issue);

(b)  The date the dividend is declared, and the payment date;

(c)  The total dividend amount payable (or, in the case of a bonus issue, the amount for tax purposes of the bonus issue);

(d)  The total amount of imputation credits attached (this amount must be shown as nil if no imputation credits are attached);

(e)  The imputation ratio of the dividend;

(f)  If the dividend was paid in Australian currency by an Australian imputation credit account company, the exchange rate used to calculate the imputation ratio; and

(g)  Such other information as the CIR may require.
If the company attaches a FDP credit to a dividend, the company dividend statement also must include the following:

(a) The total amount of FDP credits attached;
(b) The FDP ratio of the dividend; and
(c) The combined imputation and FDP ratio of the dividend, if imputation credits are also attached.

If a CTR credit is attached to the dividend, the statement must further include [TAA, s 68A]:

(a) The amount of the s LQ 5 additional dividend paid;
(b) The FDP ratio of the dividend calculated as if the CTR credit was a FDP credit; and
(c) If an imputation credit is also attached to the dividend, the combined imputation and FDP ratio of the dividend calculated as if the CTR credit was a FDP credit.

Company dividend statements must be filed with the CIR within the period allowed for filing the company’s income tax return for the income year of the company that corresponds to the tax year in which a dividend was declared.

Qualifying companies have special shareholder and company dividend statement requirements [see 1160.65].

**670.65 Annual and other imputation returns** [TAA, ss 69, 70]

An imputation credit account (ICA) company must file an annual imputation return in the prescribed form, following the end of each tax year and within the period allowed for filing the company’s income tax return for the corresponding tax year. This will normally be done as part of the company’s income tax return.

The return must show the opening and closing balances of the ICA for the tax year, the amount and source of all debits and credits to the ICA for the year, and any amounts of further income tax or imputation penalty tax payable, and such other information as the CIR may prescribe.

If the company is a branch equivalent tax account (BETA) company [see 670.290], the return must show the opening and closing balances and the amount and source of all debits and credits to the BETA for the tax year. If the company is a policyholder credit account (PCA) company [see 800.40], corresponding details for the PCA must be shown. A conduit tax relief (CTR) company must provide corresponding details of the entries for the tax year to its CTR account [TAA, s 69(1)(ea), see 215.50 to 215.60]. For annual return requirements for FDPA companies [see 670.190].

Qualifying unit trusts and group investment funds that derive category A income must show the opening and closing balances of the trust’s supplementary available subscribed capital account for the tax year and the amount and source of all credits and debits that have arisen in the trust’s or fund’s supplementary available subscribed capital account [see 1450.65].

If the company is a qualifying unit trust or a group investment fund that derives category A income, the opening and closing balances of the supplementary available subscribed capital account, along with all debits and credits arising to that account in accordance with ss OF 4 and OF 5 must be disclosed.

Other circumstances in which an imputation return is to be furnished [under s 70 of the TAA] are:

(a) As and when required by the CIR for any specified period (eg if Inland Revenue considers that ICA entries may be incorrect).

(b) Where the company ceases to be an ICA company (eg on liquidation), in which case it must furnish a return within two months of the cessation date, for the period from the start of the tax year and ending on the cessation date.

(c) An ICA company can choose to file a return for a period from the first day of a tax year up to a date within that tax year specified by the company. The company must file such a return within seven days of the date specified. The reason for doing this would normally be to establish the ICA balance at the specified date for tax refund purposes [see 670.70].
**670.70**  **Limits on refunds to company of income tax**  [ss LA 6, LA 7, LA 8, RM 13, RM 14, RM 15, RM 16, RM 17]

(1) **General position**

Rules that authorise the CIR to refund income tax paid in excess of the amount properly payable, for taxpayers generally, are set out in ss LA 6 to LA 8 [see 1215.30]. However, under ss RM 13 to RM 17, the amount of tax refund payable to an imputation credit account (ICA) company is limited to the credit balance (if any) of the company’s ICA at the later of:

(a) The end of the previous tax year; or

(b) The last day of any period for which the company has chosen to file an imputation return, or has been required by the CIR to file an imputation return, for a period other than a tax year, under s 70 of the TAA [see 670.65].

Notwithstanding these limitations, where a company files its imputation return prior to the end of the next tax year under an extension of time arrangement, the company is able to obtain a refund provided that the amount does not exceed the balance in the imputation credit account on the last day of the earlier income year for which the return was filed.

Refundable income tax paid in excess, for an ICA company, does not include any further income tax [see 670.95] paid under s OB 65.

Where a company has ceased to be an ICA company, and is entitled to a refund of income tax for an income year during which it was an ICA company, the refund is limited to any credit balance in the ICA at the time of cessation (ie the refund cannot exceed the debit to the ICA that arose on cessation).

Where the company receives more than one refund during the same tax year, its entitlement to a later refund is determined by reducing the relevant ICA credit balance by the earlier refunds of income tax or FDP received.

However, in the case of a qualifying company [see 1160.10] these restrictions on refunds of tax overpaid do not apply, except in circumstances where the tax was overpaid as part of an avoidance arrangement [s RM 32].

The ICA credit balance, for refund purposes, is deemed to be increased by the amount of any prior debit to the ICA under s OB 41 for breach of shareholder continuity provisions, where the continuity breach occurred after the first provisional tax instalment payment date for the income year to which the refund relates. This means that in such circumstances a company may receive a refund of income tax up to the amount of any ICA credit balance existing prior to loss of continuity (in addition to any ICA credit balance subsequently arising) [see TIB vol 3:7 (April 1992) at 17].

There is no restriction on refunds of tax paid if the payment of tax did not give rise to an ICA credit because of one of the exclusions listed in ss OB 4, OZ 1 [see 670.30].

For the provisions that apply to company amalgamations [see 180.110].

Where overpaid income tax is not refunded to the company because of the restrictions above, the amount not refunded is credited against any income tax or provisional tax liability of the company that has arisen for any income year. Any excess still remaining is retained by the CIR [ss RM 16, RZ 6].

Where such an amount not refunded is applied by the CIR to another income tax or provisional tax liability of the company, a further ICA credit is not permitted [see 670.30]. However, if the non-refunded amount is instead applied by the CIR to satisfy some other tax liability (eg GST) of the company, debits arise to the ICA [see 670.35].

To accommodate the comprehensive tax transfer rules, no debit or credit arises to the imputation credit account where an amount of tax paid in excess is credited against an amount of income tax or provisional tax payable by the company.

For similar rules applying to limit refunds of FDPs [see 670.140].
(2) **Anti-avoidance**

With effect from 16 November 2004, measures apply to prevent a company with overpaid tax but no, or limited, imputation credits from being sold to an imputation credit rich group of companies. The effect of such a transaction was that the overpaid tax was refundable to the new group notwithstanding that the benefit of that tax has already been enjoyed by the shareholders of the original group in the form of imputation credits attached to dividends.

Section OB 71 applies to companies which are leaving a wholly-owned group that have available net losses in excess of $1 million at the end of the previous tax year. Such companies are able to elect, immediately before leaving the group, that a debit balance in its ICA, or an amount of prepaid tax that exceeds the credit balance of its ICA, be transferred to another company in the group. Alternatively (but unlikely) the company may choose to pay additional income tax of an amount equal to the debit balance or excess amount of prepaid tax. This additional tax is a final tax and cannot be credited against other tax liabilities. Where a company fails to either make the transfer or pay the additional tax, s OB 72 requires the company to make payment of the additional tax after it has joined the new group. The same treatment is provided for consolidated groups under s OP 6.

**670.75 Shareholder continuity requirements** [ss GB 34, OA 8, OB 41]

For an imputation credit account (ICA) company (other than a qualifying company) [see 1160.68] to continue to carry forward imputation credits, it must satisfy the shareholder continuity provisions. If the shareholder continuity provisions are breached, a debit arises to the ICA at that time [see 670.35]. The debit extinguishes credits in the ICA which have not been cancelled out by a (prior or subsequent) debit. In other words, any ICA credit balance is effectively lost at the time of a breach of the shareholder continuity provisions. This is intended to prevent trafficking in ICA companies (ie to ensure that the benefit of imputation credit utilisation is restricted to substantially the same group (at least to the extent of 66 per cent continuity) of shareholders who effectively bore the company’s tax liabilities that gave rise to the imputation credits) [s OA 8].

Under s OB 41 a debit arises at any time, equal to the amount of any particular ICA credit (unless that credit has been cancelled out, before the specified time, by a prior or subsequent debit), unless there is a group of persons:

(a) Whose aggregate minimum voting interests in the company is at least 66 per cent for the period from the date on which the credit arose until the specified time; and

(b) If a market value circumstance exists at any time during that period, whose aggregate minimum market value interests in the company for the period is at least 66 per cent.

For this purpose, the minimum voting interest or market value interest of any person is equal to the lowest voting interest or market value interest held by the person in the company during the period [s OZ 4].

For the determination of voting and market value interests of a shareholder in a company, and whether a market value circumstance may exist [see 170.15 to 170.35], Essentially (subject to certain exceptions noted below), the ICA continuity provisions parallel the company loss carry forward rules (with the substitution of 66 per cent for 49 per cent) [see 940 LOSSES]. Special rules [ss YC 7 to YC 19] that apply in determining continuity of voting interests and market value interests of shareholders for both ICA and loss carry forward purposes are discussed in 170.35. See 940.20 for examples of determining the minimum voting interests of shareholders during a period where shareholdings in a company change.

The exceptions, where the determination of voting interests, market value interests, and market value circumstances under the ICA continuity provisions differ from those under the company loss continuity provisions, are contained in s YC 20. These relate to excluded securities (ie fixed rate shares and ss FA 2 and DB 10 debentures) issued after 30 July 1991. For ICA continuity purposes, such instruments are also taken into account as comprising shares in the company [see TEO Newsletter 43 (14 August 1991) at 4].

Debits to the ICA are offset against credits in the order in which the credits arose [s OZ 4].
ICA continuity anti-avoidance rules are contained in s GB 34. Where shares have been subject to arrangements, or have had rights extinguished or altered, to enable the company to meet the ICA continuity requirements, the company is deemed not to have met those requirements.

(1) Concessional tracing rules and continuity provisions

Concessional tracing rules exist in certain circumstances (as for loss continuity) [see 170.35]. These are principally for transfers under wills, interests of less than 10 per cent, widely-held companies or unit trusts, listed companies, building societies, statutory producer boards and subsidiaries [see 670.85], co-operative companies [see 670.90], and certain foreign companies.

(2) FDPA and BETA continuity requirements

Both the foreign dividend payment account (FDPA) and the branch equivalent tax account (BETA) of a company are subject to shareholder continuity requirements identical to those above [see 670.195, 670.325].

670.80 Record keeping [TAA, s 22]

Records relating to credits and debits to the imputation credit account (ICA), foreign dividend payment account (FDPA), and branch equivalent tax account (BETA) of a company are required to be maintained by the company [TAA, s 22(2)(b)], for a period of at least seven years as is the case for taxpayer record-keeping requirements generally. The records that must be maintained include those of the ICA, FDPA, and BETA, company dividend statements, and details of foreign dividend payments received. For the form in which records may be kept [see 1210 RECORDS OF TAXPAYERS].

670.85 Statutory producer boards [ss OB 73, OB 74, OB 75, OB 76, OB 77]

Statutory producer boards, which are companies for tax purposes and hence generally required to maintain an imputation credit account (ICA), are essentially primary producer and marketing boards and authorities. They are listed in sch 37 as being the New Zealand Horticulture Export Authority, the New Zealand Meat Board, and the New Zealand Pork Industry Board. They generally derive income by way of levies, and may purchase goods, from their members, and pay rebates to members. They are mutual associations subpart HE, but unlike other mutual associations they are able to deduct the entire amount of rebates paid to members for relevant member transactions [see 225 COOPERATIVES, STATUTORY PRODUCER BOARDS, MUTUAL ASSOCIATIONS, CLUBS, AND SOCIETIES]. As they do not have conventional shareholding structures, special provision is made for them to attach imputation and foreign dividend payment (FDP) credits to actual or notional distributions to members.

A member [s YA 1] of a statutory producer board for this purpose, in relation to a year of determination, must be a New Zealand resident who either was liable to pay a levy to, or entered into produce transactions with, the producer board in respect of that year. A year of determination is a 31 March year [s YA 1].

A statutory producer board that is an ICA company is authorised [s OB 73(1)-(3), (8)] to determine, for a year of determination, to distribute imputation credits to members by making either:

(a) A cash distribution that the producer board elects on or before the date of determination not to claim (wholly or partly) as an allowable deduction. The non-deductible amount is then treated as a dividend to which imputation credits may be attached; or

(b) A notional distribution with imputation credits attached for all persons who were members at any time during the year of determination.

For either type of distribution, the determination by the statutory producer board must be made during the six-month period that follows the 31 March end of the relevant year of determination. More than one such determination can be made, for any particular year.

(1) Cash distribution

A cash distribution must be made for all persons who were members at any time during the year of determination, and must be based on each member’s proportionate share of total produce transactions (supplies to the board of produce or goods that are trading stock), or on each member’s proportion of levies...
payable, or by some other CIR-approved method. The amount to be treated as a dividend must otherwise have been deductible to the producer board (eg as a rebate under s HE 3) [s DV 18]. Notice in writing of the election must be provided to the CIR within the period allowed for filing the producer board’s income tax return for the corresponding income year. The aggregate amount of imputation credits to be attached to a cash distribution is calculated by multiplying the actual cash distribution amount by a fraction equal to the maximum imputation ratio (currently 30/70) for the relevant income year [s OB 73(4)-(7)]. In other words, the amount of cash distribution is to be fully imputed.

The amount of imputation credit to be allocated to each member is calculated by multiplying the aggregate amount of imputation credits attached to the cash distribution by the proportion of the cash distribution paid to the member.

**Example:**

A member receives a payment of $15,000, out of a total cash distribution of $200,000. The aggregate amount of imputation credits to be attached to the total cash distribution is $85,714.29 ($200,000 × 30/70). The amount of imputation credits allocated to the member is $6,428.57 ($85,714.29 × 15,000/200,000).

**Notional distribution**

A notional distribution is simply a mechanism that allows the producer board to allocate imputation credits to members, without having to make actual cash payments (similar to a company making a taxable bonus issue of shares). When allocating imputation credits to members, different rules [s OB 74] apply for notional distributions. Here the producer board can choose any of the following alternative bases:

(a) Produce transactions with members;
(b) Levies payable by members;
(c) A combination of the above, where it is appropriate to take into account both produce transactions and levies payable; or
(d) Any other method that the CIR approves (eg if the profitability of different types of produce transactions varies).

Where the produce transactions allocation method is adopted, the amount of imputation credit to be allocated to each member is calculated by multiplying the aggregate amount of imputation credits attached to the notional distribution by the proportion of the member’s produce transactions to the total produce transactions of all members during the year of determination [s OB 74].

Where the levies payable allocation method is adopted, the amount of imputation credit to be allocated to each member is calculated by multiplying the aggregate amount of imputation credits attached to the notional distribution by the proportion of levies payable by the member to total levies payable by all members for the year of determination [s OB 74].

The CIR can override and recalculate the producer board’s allocation of imputation credits to members, where the CIR is satisfied that the producer board’s allocation method does not result in a fair and reasonable allocation of imputation credits to a member. This power could be used by the CIR to counter any streaming of imputation credits to particular members.

The amount of dividend that is deemed to be paid to each member by the producer board, and to have been derived by each member (on the date of the producer board’s determination) is [s OB 75]:

\[
\text{Dividend} = \left( \frac{\text{Credit attached}}{\text{Tax rate}} \right) - \text{Credit attached}
\]

Where:

“Credit attached” is the amount of imputation credit attached to the member’s distribution;

“Tax rate” is the basic rate of income tax for companies for the year of determination.

This formula effectively excludes the amount of the imputation credit from the amount of the notional deemed dividend (ie it notionally corresponds to the “paid” amount of a dividend). However, the amount of the imputation credit is also to be included in the member’s income [see 670.50], so that the member is entitled to receive a credit of tax for the imputation credit.
Details of a notional distribution must be supplied to the CIR with the producer board’s income tax return for the income year in which the board’s determination is made [s OB 75]. In addition, records must be maintained that will enable the CIR to determine whether any subsequent actual distribution (for the amount notionally distributed and notionally capitalised by the board) is to be exempted from tax under certain provisions of s CD 26 (these exemptions apply to a return of capital levies on any dissolution of the board, or a subsequent cash distribution under s DV 18 in respect of an amount that has already been treated as a notional distribution under s OB 75).

Where the statutory producer board maintains a foreign dividend payment account (FDPA), FDP credits can be passed on to members in the same manner as imputation credits. If the board determines to attach both imputation credits and FDP credits for any year of determination, then it must do so at the same time [s OB 76].

A statutory producer board is a special corporate entity [s YA 1], to which breach of shareholder continuity provisions will not apply, where the board has issued no shares [see 670.75].

670.90 Co-operative companies [ss OB 78, OB 79, OB 80, OB 81, OB 82]

The rules relating to the distribution of imputation credits by a co-operative company are set out in ss OB 78 to OB 82. As for statutory producer boards, the normal imputation credit allocation rules [see 670.45] do not apply to co-operative companies, and instead the co-operative company can make a determination to pay its shareholders an otherwise deductible cash distribution as a dividend, or to make a notional distribution to its shareholders, with imputation credits attached in either case.

A co-operative company (defined to exclude a statutory producer board) [s YA 1] will include any co-operative entity that is a company for tax purposes. Like statutory producer boards, such companies may enter into produce transactions with their members. They will normally be mutual associations, and hence able to deduct rebates paid to members under the rules contained in subpart HE [see 225 COOPERATIVES, STATUTORY PRODUCER BOARDS, MUTUAL ASSOCIATIONS, CLUBS, AND SOCIETIES].

The allocation rules apply for the shareholders of a co-operative company. “Shareholder” for this purpose includes a sharemilker who derives payment for produce transactions directly from a co-operative dairy or milk company [s YA 1]. In that capacity, the sharemilker may receive dividends with imputation credits attached under these rules.

For a year of determination, a co-operative company can make only one determination for each of the cash distribution and notional distribution alternatives [s DV 18]. However, it may make both a cash distribution and a notional distribution, both with imputation credits attached, in respect of a year of determination.

The imputation credit allocation rules for co-operative companies, and the income tax treatment of each type of distribution, are identical to those for statutory producer boards [see 670.85], except for the following:

(a) A cash distribution to shareholders can be based only on shareholders’ produce transactions with the company [s DV 18].

(b) Produce transactions [s YA 1] in this case include both sales by shareholders to the company and sales by the company to shareholders, if these are both a principal activity of the company (of produce or goods that are trading stock).

(c) For a cash distribution, the company’s election must be by way of notice in writing to the CIR on or before the day (during the period of six months following the end of the year of determination) it makes the distribution [s DV 18].

Details of a notional distribution must be supplied to the CIR with the co-operative company’s income tax return for the income year in which the company’s determination is made, and similar records of the distribution [see 670.85] must be subsequently maintained [TAA, s 64].

If the company maintains a foreign dividend payment account (FDPA) foreign dividend payment (“FDP”) credits may be passed on to shareholders in the same manner and at the same time as imputation credits.

A co-operative company will generally be a “limited attribution company” [s YA 1], for the purposes of the shareholder continuity provisions. This is relevant for imputation credit account (ICA), FDPA, and branch
equivalent tax account (BETA) shareholder continuity purposes for a company in which the co-operative company holds less than a 50 per cent interest [see 170.35].

670.95 Further income tax for company with ICA debit balance at year end or on ceasing to be an ICA company [ss OB 65, OB 66, OB 67, OB 68, OB 69, OB 70]

Further income tax is an amount of tax that is imposed if the imputation credit account (ICA) has a debit balance at 31 March or when the company ceases for any reason to be an ICA company. It is payable by the following 20 June for a company with a 31 March ICA debit balance, and by the date of ceasing to be an ICA company for a company that has a debit ICA balance at that date [ss OB 65, OB 66]. The amount of further income tax is the amount of the debit balance. It may arise, for example, if imputation credits in excess of company tax paid have been distributed to shareholders.

In addition, where a company has a 31 March ICA debit balance, imputation penalty tax (also payable by 20 June) of 10 per cent of the further income tax is also imposed [see 670.100].

Further income tax paid can be credited against any income tax or provisional tax liability of the company in relation to an income year that corresponds with a tax year in which the company was an ICA company. The credit for the payment arises on the date on which the CIR receives the further payment [s OB 7]. The payment, if made after the end of the tax year in relation to which the further income tax liability arose, may also be credited against the company’s liability to pay the further income tax [s OB 69].

Payment of further income tax gives rise to an ICA credit, on the date the tax is paid [s OB 4(4)]. However, payment of a subsequent tax liability by way of crediting further income tax previously paid does not give rise to a subsequent ICA credit [s OB 4]. It is not refundable to the company [see s RM 17 and 670.70].

Further income tax is not applicable where the debit balance arises solely because a debit amount arises from expenditure being transferred from the company, being a member fund, to a master fund in accordance with s DV 5.

A company that has a debit balance in its ICA at year-end may apply in writing to the CIR for a reduction in the amount of further income tax payable if:

(a) The company had a debit balance in its ICA at the end of the immediately preceding tax year; and
(b) The debit balance in the immediately preceding income year exceeds the total credits that have arisen to the ICA during the tax year.

The amount of the reduction is equal to the difference between the debit balance in the ICA and the total of credits that have arisen during the tax year.

Further income tax for a qualifying company may similarly be reduced or extinguished where a qualifying company’s ICA debit balance is attributable to income tax refunds received. Section OB 67 provides for any further income tax that the company is otherwise liable to pay to be reduced by the following amount:

\[ \text{refunds} - \text{credits} \]

Where:

“Refunds” is the total amount of all refunds paid to the company before the debit balance creating the liability for further income tax arises;

“Credits” is the total of all credits in the ICA for the period that runs from the tax year in which the first refund was received to the time the calculation is made.

This concessionary provision is intended to mitigate the potentially adverse impact of the imputation credit anti-streaming rules that apply to qualifying companies, where such a company has overpaid tax and subsequently receives an income tax refund. Because dividends paid by a qualifying company are deemed to have imputation credits attached to the fullest extent possible [see 1160.70], where such a company overpays tax and pays dividends in one tax year and then receives a refund in a subsequent income year, an ICA debit balance may result. The provisions grant relief from further income tax in these circumstances.
However, the ICA debit balance will remain, and so will roll forward into the subsequent tax year. See TIB vol 7.9 (February 1996) at 19, for examples of the application of these rules to qualifying companies.

**670.100 Liquidation of company** [ss OC 18, RM 18; TAA s 140B]

When a company is wound up, it ceases to be an ICA company on the day the Registrar of Companies declares the company to be dissolved. The liquidator must pay out any distributions to shareholders prior to this date. Any income tax liabilities [see 170.60] also need to be paid before this date, if credits are to arise to the ICA that can be attached to distributions to shareholders. See 270 DIVIDENDS for the rules that determine to what extent distributions on a winding up are dividends to which imputation credits can be attached. The normal imputation credit allocation rules apply, and a liquidator may need to file a ratio change declaration [see 670.45] for final distributions. The final imputation return must be filed within two months [see 670.65].

When a company is in the process of liquidation (ie liquidation duties have not been completed) and has an ICA debit balance at 31 March, both further income tax and the 10 per cent imputation penalty tax will be payable by 20 June. However, where the company has an ICA debit balance immediately prior to removal from the New Zealand companies register, further income tax is payable, no imputation penalty tax is charged [TAA, s 140B], and the further income tax is due for payment by the date of removal [see 670.95] (ie two months prior to the due date for furnishing the final imputation return). Normal late payment penalties apply [see 670.105, 670.110].

Where the company has overpaid income tax, any refund payable to the liquidator is limited to the amount of the ICA credit balance immediately before the date of removal from the NZ companies register [see s RM 14 and 670.70].

If the company maintains a FDPA and this has a credit balance, the liquidator can elect to transfer the FDPA balance to the ICA at either 31 March or immediately before the date of the company’s removal [s OC 18, see 670.165]. The liquidator may wish to do so to clear or reduce an ICA debit balance, or to increase an ICA credit balance so as to maximise the amount of any tax refund that is due to the company.

See also TIB vol 6:11 (April 1995) at 4-14, for examples of the application of these rules to companies in liquidation.

**670.105 Imputation credit account penalties and use of money interest**

[TAA, ss 120D, 139B, 140B]

Imputation penalty tax of 10 per cent of the amount of any further income tax for a 31 March ICA debit balance, payable by the following 20 June, applies under the penalty regime [TAA, s 140B]. If further income tax and the 10 per cent imputation penalty tax (of more than $100) are not paid by 20 June, late payment penalties will apply [TAA, s 139B]. The initial penalty is one per cent and a further four per cent six days later with an incremental penalty of one per cent per month thereafter (compounding) [see 1110.40].

In addition, use of money interest, calculated on a daily basis, is payable [TAA, s 120D] on any further income tax, imputation penalty tax, and late payment penalties, where payments (of more than $100) are made after due dates [see 1110.295]. Other general penalties potentially applicable include shortfall penalties [see 1110.185].

There are three situations where the CIR is required to remit imputation penalty tax (relating to a 31 March ICA debit balance) [TAA, s 180]:

(a) To the extent that the debit balance arose through the CIR debiting the ICA in reliance on the ss GB 35 and GB 36 anti-avoidance provisions, but that debit has subsequently been reversed [see 670.30];

(b) To the extent that the debit balance arose from an income tax refund having been sent but not received, or not known by the company to have been received, before the tax-year end; and
(c) To the extent that the debit balance arose because overpaid income tax or FDPs was applied by the
CIR against some other tax liability (eg GST) of the company or of a consolidated group, and the
taxpayer was not aware of this in sufficient time to clear the 31 March ICA debit balance position.

In these situations the CIR must also remit any corresponding late payment penalty that has arisen for the
imputation penalty tax. In situation (a) only, the CIR must also remit any late payment penalty that has arisen
on the corresponding amount of further income tax.

The CIR also has discretion to remit imputation penalty tax or a late payment penalty for reasonable cause
[see 1110.335]. The CIR’s policy as to what will be regarded as reasonable cause is set out in TIB vol 9:13
(December 1997) at 2. All requests for remission must be made in writing.

670.110 Anti-avoidance stapled stock provisions [ss GB 37, LE 1(5)]

The anti-avoidance provisions of s GB 37 prevent a company that is not entitled to impute credits to
shareholders from doing so by way of a “stapled stock” arrangement in which its shareholders are instead
paid a dividend with imputation credits attached from some other company. An example of a stapled stock
arrangement is where a non-resident company that is not entitled to maintain an imputation credit account
(ICA) has New Zealand shareholders and also has a New Zealand subsidiary company, issues shares to those
shareholders that are “stapled” to shares in the subsidiary, so that the shareholders become entitled to receive
imputed dividends from the subsidiary instead of dividends from its parent company. Various other “stapled
stock” scenarios are also possible, including where an ICA company has insufficient ICA credits to pass on
to shareholders.

There are two principal types of arrangement caught under the s GB 37 provisions. These are where an
arrangement has been entered into which has as one of its purposes (not necessarily its sole or dominant
purpose) that:

(a) A shareholder of a company may be paid a dividend by another company, whether directly or
indirectly by any means whatever; or

(b) A shareholder of a company may acquire shares in another company so that the other company may
pay a dividend to the shareholder.

The provisions also apply to similar arrangements where it is an associated person of the shareholder, or a
beneficiary of a trust of which the shareholder is a trustee, or a person associated with such a beneficiary,
who may become entitled to receive a dividend from that other company, or who may acquire shares in that
other company for which the other company may pay a dividend, as the case may be.

Where such an arrangement exists, the consequences are:

(a) Any dividend paid to the shareholder, or trustee, or associated person, as the case may be, is deemed
for imputation purposes to have been paid by the company, not by the other company;

(b) The amount of any imputation credit attached to a dividend is not available as a tax credit, or for
conversion into a carry forward tax loss, to the recipient (and is not included in gross income of the
recipient). However, if the company is an ICA company, its ICA is debited with the amount of the
imputation credit attached to the dividend by the other company.

Note: Shares, for s GB 37 purposes, can include a debenture to which s FA 2 (floating rate debenture issued
in substitution for shares) applies.

670.115 Anti-avoidance provisions tax advantage arrangements [ss GB 35,
GB 36, GB 37]

There are also more general imputation anti-avoidance rules, which apply to an “arrangement to obtain a tax
advantage”. Broadly, these are designed to counter two types of possible arrangements:

(a) The buying or selling of shares for the purpose of subsequently paying dividends with imputation or
foreign dividend payment (FDP) credits attached to persons best able to utilise them; or
(b) The streaming of dividends with imputation or FDP credits attached to different shareholders, or
different classes of shareholders, including where this takes place over more than one tax year, so as
to direct those credits to those shareholders to whom the credits are more useful.

In the case of the second type of arrangement, the anti-streaming provisions of s GB 35 reinforce the allocation
and benchmark dividend rules [see 670.45]. Those rules require only that any dividends paid within a tax
year are equally imputed (unless a ratio change declaration has been filed by the company, and no arrangement
has been entered into to obtain a “tax advantage” [s YA 1]). However, s GB 34 also catches the situation
where dividends are streamed to different shareholders across more than one tax year (eg through adopting
differing benchmark dividend imputation ratios in different years).

“Tax advantage” means either:

(a) Where a credit arises to the ICA or foreign dividend payment account (FDPA) of a company (eg
where the company receives an imputed dividend — this is termed an “account advantage”); or
(b) Where, for a shareholder (company or individual), a credit of tax is allowed for imputation or FDP
credits attached to dividends received, or where a non-resident or exempt shareholder obtains a refund
of such FDP credits (this is termed a “tax credit advantage”).

In terms of the types of arrangement that the provisions set out to counter, s GB 35 provides that there is an
“arrangement to obtain a tax advantage” where either:

(a) An arrangement for the issue or sale or other disposition of shares exists, and all of the following
apply:
   (i) Any person who is a party to the arrangement might reasonably have anticipated that a
       dividend would be paid for the shares in any income year;
   (ii) Any person who is a party to the arrangement might reasonably have anticipated that an
       imputation credit or a FDP credit would be attached to the dividend;
   (iii) Any person who is a party to the arrangement might reasonably expect either that a party to
       the arrangement will be able to obtain a tax advantage, or that a party to the arrangement will
       not be able to obtain a tax advantage, in relation to that imputation credit or FDP credit; and
   (iv) The purpose (not being an incidental purpose) of the arrangement is that a party to the
       arrangement would obtain such a tax advantage [s GB 35]; or

(b) The company streams the payment of dividends, or the attaching of imputation or FDP credits or
both to any dividends (for one or more distributions, including bonus issues, whether occurring in
the same tax year or over more than one tax year) in such a way as to give higher credit values to
persons who will obtain a tax advantage from them than to persons who will not so obtain a tax
advantage or who may reasonably be expected to derive a lesser benefit from any tax advantage.

For the purposes of (b) above, a dividend will have a “higher credit value” than another dividend if it has a
higher imputation ratio or FDP ratio than the other dividend, or if it has an imputation credit attached and
the other dividend does not, or if it has a FDP credit attached and the other dividend does not.

Where the CIR determines that such an arrangement to obtain a tax advantage exists, the CIR can make
determinations on the following matters:

(a) Whether the arrangement gives rise to an account advantage (ie credits to the ICA or FDPA), or to
a tax credit advantage (ie tax credits to the shareholder), or both;
(b) The amount of the imputation credit or FDP credit that is to be regarded as being the subject of the
arrangement;
(c) The tax year in which the arrangement is to be regarded as having occurred or commenced (which
is the year where the first reasonably identifiable step towards its implementation occurred); and
(d) For a dividend streaming arrangement to which some other person besides the company is a party
(ie where it is not the case that the company alone is responsible for the arrangement), whether it is
the dividend recipients or the company that should be penalised. This is determined by the CIR under s GB 36 (see below).

1) Application of s GB 36

The provisions apply to:

(a) Any arrangement for the issue of shares or the sale or other disposition of shares; or
(b) Any arrangement involving the streaming of dividends to which a person other than the company is a party (ie where the company is not solely responsible for the arrangement), unless the CIR decides that the arrangement should be dealt with (as below).

Under these provisions, the consequences are:

(a) No credit of tax, or refund of FDP, is available to a recipient of a dividend under the arrangement, for the amount of imputation credit or FDP credit that the CIR determines to be the subject of the arrangement; and
(b) A debit of that amount arises (at the end of the tax year determined to be the year in which the arrangement occurred or commenced) to the ICA or FDPA, as the case may be, of any company that would otherwise obtain an account advantage from the arrangement (ie any company that receives an imputed dividend under the arrangement).

2) Streaming dividends

The provisions apply to an arrangement involving the streaming of dividends where either:

(a) The company paying the dividends is the only party to the arrangement (ie it is solely responsible for the arrangement having been put into place); or
(b) The company is not the only party to the arrangement but the CIR determines that these consequences should apply to the arrangement.

The consequences are:

(a) A further debit arises to the ICA or FDPA, as the case may be, of the company that pays the dividends, at the end of the tax year determined to be the year in which the arrangement occurred or commenced. The debit is equal to the amount of imputation credit or FDP credit that the CIR determines to be the subject of the arrangement; or
(b) The recipients of dividends are not penalised.

In other words, whereas the first consequence denies the benefit of imputed dividends to recipients (and also penalises an ICA company that is a dividend recipient). The second consequence penalises only the company paying the dividends.

Note: Shares, for s GB 35 purposes, can include a debenture to which s FC 1 (floating rate) or s FC 2 (debenture issued in substitution for shares) applies.

These anti-streaming provisions also apply to conduit tax relief (CTR) credits attached to dividends [see 215.65]. For these purposes, and for the definitions of FDP ratio and combined imputation and FDP ratio, a CTR credit is treated as being a FDP credit, with corresponding consequences. However, to the extent that a further debit arises through a CTR credit being treated as if it was a FDP credit, the further debit is debited to the dividend-paying company’s CTR account [see 215.75] and not to its FDPA [s OD 18].

670.120 FDP rules [subpart OC]

1) FDP rules repealed

Following the exemption for most foreign dividends received by companies in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009, from income years beginning on or after 1 July 2009, the foreign dividend payment (FDP) rules have been repealed. Foreign dividend payment accounts will be gradually phased out.
Subpart RG has been repealed for income years beginning on or after 1 July 2009 to remove the liability for resident companies to pay foreign dividend payments on dividends that they receive from foreign companies. As a result, most foreign dividends received by companies will be wholly exempt, but in some cases, income tax will be payable [see 270.80].

Sections OC 4, OC 5, and OC 30 to OC 34 have been amended to replace “further FDP” with “further income tax”.

Sections OC 6, OC 8, OC 9, OC 10, OP 56, OP 61 and OP 62 have been repealed to prevent new FDP credits from being generated.

Note: Inland Revenue advise in their special report on the changes to the international tax rules that companies will have five years to distribute their existing FDP credit balances to shareholders before any remaining balances are converted into imputation credits. This will be legislated for as part of a subsequent tax Bill.

(2) Previous rules

The foreign dividend payment (FDP) regime applies to foreign-sourced dividends received by a resident company, and is closely connected to the imputation regime. The company is required to make a deduction of FDP from the dividend received, and to pay the FDP deducted to the CIR on a quarterly basis. The amount of FDP then becomes available as either a FDP credit or an imputation credit (depending on whether the company elects to maintain a foreign dividend payment account (FDPA) [see 670.145] that can be attached to dividends paid by the company to its shareholders [see 670.170].

As for imputation credits, FDP credits attached to dividends paid are included in the shareholder’s income, and the shareholder is entitled to a corresponding credit of tax. However, unlike imputation credits, FDP credits in excess of the shareholder’s income tax or non-resident withholding tax (NRWT) liability are refundable to the shareholder [see 670.185].

When a company receives a foreign-sourced dividend, the FDP deduction required is calculated at the 30 per cent basic rate of income tax for companies, but with a credit for foreign withholding tax deducted at source. In addition, a credit against FDP payable is available under the underlying foreign tax credit (UFTC) rules, in respect of foreign income tax imposed on the profits of the dividend-paying company from which the dividend is sourced [see 670.130].

If the resident company elects to maintain a branch equivalent tax account (BETA), for attributed foreign income that it derives under the international tax rules from a shareholding of 10 per cent or more in a controlled foreign company (“CFC”), or from certain foreign investment fund (FIF) interests, then it can also offset credits for New Zealand income tax paid on its attributed foreign income against the FDP liability on a dividend that it receives from that CFC or FIF [see 670.130, 670.285]. This is to prevent double taxation arising when the company receives a dividend that is sourced from profits of the CFC or FIF that have already been subject to New Zealand income tax under the international tax rules.

The converse situation also applies for a BETA company (ie it is able to offset FDP paid on foreign dividends received against its income tax liability on attributed foreign income derived from a CFC and from certain FIF interests) [see 670.285]. This is to prevent double tax arising when the resident company pays FDP on a foreign dividend received before it pays New Zealand income tax on the attributed foreign income from which the dividend is sourced.

The FDP liability on a dividend received by a conduit tax relief (CTR) company is further reduced in proportion to its percentage of non-resident shareholders [see 670.130].

Any resident company can elect to maintain a FDPA. If it does so, FDP paid is credited to its FDPA rather than to its imputation credit account (ICA), and can then be attached as FDP credits to dividends paid to its resident or non-resident shareholders (subject to the rules that restrict the attaching of FDP credits to dividends paid to non-resident shareholders of a CTR company) [see 670.170]. A company is likely to maintain a FDPA if it has significant non-resident shareholders who would benefit from refunds of FDP credits in excess of New Zealand NRWT liability [see 670.145].
Imputation

Under the CTR rules, credits to a company’s FDPA also arise for New Zealand income tax payable on any foreign attributed income that it derives, by way of transfer of the credits from its ICA to the FDPA [see 670.35]. Accordingly, such credits can also be attached as FDP credits to dividends paid to the company’s shareholders [see TIB vol 10:4 (April 1998) at 13].

A FDPA credit balance can be transferred to a company’s ICA at tax-year end or immediately before a company ceases to be resident (provided the company is not a conduit tax relief company) [see 670.165].

670.125 Liability to deduct FDPs [ss RG 2, RG 3]

Every resident company that is paid a foreign-sourced dividend is obliged to deduct from it an amount of foreign dividend payment (FDP) [s RG 3, see also s BE 1(6)]. This applies to the following foreign dividends [s RG 2]:

(a) Dividends paid by a foreign company [s YA 1], which are exempt income to the resident company [ss CW 9 to CW 11]; or
(b) Dividends paid by a resident company, where that company was previously non-resident, if the dividend is exempt income to the recipient under s CW 10 (eg dividends within a wholly-owned group). Such a dividend is subject to a FDP deduction to the extent that the amount of dividend is less than the amount of retained profits that the payee company had available for distribution (less any similar dividends previously paid) immediately before becoming resident in New Zealand.

The provision in (b) is aimed at preventing a non-resident company from changing residence to New Zealand and then distributing tax-free profits accumulated overseas.

Note: FDP does not have to be deducted from a dividend arising from an interest in a foreign investment fund (FIF) for a period where FIF income or loss is calculated using either of the comparative value or deemed rate of return methods [s EX 59, see 850.155].

The FDP deducted must be paid to Inland Revenue, on a quarterly basis [see 670.135].

These rules apply to any dividend that arises for tax purposes, including non-cash dividends and bonus issues, subject to the same exclusions [see 670.40] that apply under the imputation rules (except for the inclusion for FDP purposes of dividends paid on specified preference shares).

A dividend will be “paid” to the resident company where it is distributed, credited, or dealt with in that company’s interest or behalf, and this includes the issue of shares or the giving of credit for a bonus issue [s YA 1].

Dividends subject to FDP include any “attributed repatriation” [s CD 21] arising from an income interest held in a controlled foreign company (CFC), that may arise from New Zealand investments made by the CFC (as being, in effect, a deemed return of funds to New Zealand) [see 270.20, 850.80].

670.130 Amount of FDP to be deducted [ss RG 4, RG 5, RG 7]

The amount of foreign dividend payment (FDP) to be deducted from a dividend is calculated as follows [s RG 4]:

\[(\text{dividend amount} + \text{foreign tax} + \text{underlying credit}) \times \text{tax rate}) – \text{foreign tax} – \text{underlying credit}\]

Where:

“Dividend amount” is the dividend paid (after any deduction of foreign withholding tax);

“Foreign tax” is the amount of any foreign withholding tax paid (exclusive of any such tax paid in a country specified in sch 27. Foreign withholding tax [s YA 1] means a foreign tax imposed that is substantially of the same nature as New Zealand NRWT;

“Underlying credit” is the amount of underlying foreign tax credit (UFTC) calculated under s LL 2 for the dividend. If the amount of UFTC is zero, then it is the amount of any imputation credit attached to the dividend. The UFTC for the dividend is an amount that is calculated under subpart LL by reference to foreign income tax imposed on the foreign country profits that are represented by the dividend [see 670.230]. At present there are no excluded countries specified in sch 27;
“Tax rate” is the basic rate of income tax for companies applying for the quarterly period in which the dividend was paid, or where the company is a Maori authority, the basic rate applying to Maori authorities.

**Note:** The amount of FDP liability for a conduit tax relief (CTR) company is reduced by the proportion of the company’s non-resident shareholders. This is explained below.

The above formula essentially calculates the FDP liability of the recipient company as being 30 per cent (company tax rate) of the dividend “grossed up” for foreign withholding tax deducted and the UFTC, less credits for the amounts of foreign withholding tax deducted and UFTC.

### Example:

A company receives a foreign-sourced dividend of $850, net of foreign NRWT paid of $150. Assume no UFTC is available.

The FDP deduction required is:

\[
((850 + 150 + 0) \times 30\%) - 150 - 0 = $150
\]

If there was UFTC available of $300, the FDP liability would be:

\[
((850 + 150 + 300) \times 30\%) - 150 - 300 = \text{nil.}
\]

(as it cannot be negative)

Generally, the UFTC rules (in subpart LL) allow companies that have an income interest of at least 10 per cent in the foreign company to take into account income tax paid by the foreign company when calculating the FDP liability on dividends received. Where the foreign company is resident in a grey-list country, the foreign company is generally presumed to have paid foreign tax of an amount equal to New Zealand income tax on its earnings, so that a nil FDP liability generally arises from the above formula. Different rules apply where a company’s income interest in the foreign company is less than 10 per cent, or when the foreign company is not resident in a grey-list country, as discussed at 670.245.

No credit is allowed against a FDP liability for foreign withholding tax paid on the dividend unless the CIR is furnished with all information necessary for determining the amount of the foreign withholding tax, within such period as the CIR may allow [TAA, s 32N]. This period is the same as for furnishing evidence of foreign taxes paid under ss 78B and 78C of the TAA (ie within four years of the end of the relevant income year, with an extension of up to two years if the CIR permits). Where the required information is not furnished, the CIR can recover the corresponding amount of credit claimed as if it were income tax payable by the company [TAA, s 32N].

When the company receiving the dividend is, at that time, either a branch equivalent tax account (BETA) company [see 670.290], or in the same group of companies as a BETA company, and the dividend is paid for an income interest [s YA 1] (10 per cent or greater) held in a controlled foreign company (CFC) [see 850.35], the company (or the other BETA company) can elect to offset any credit balance in the relevant company’s BETA to reduce or eliminate the company’s FDP liability [see 670.310].

For this purpose, the foreign dividend is deemed to be paid for an income interest in a CFC if the recipient company held such an interest at any time during the period from the start of the income year of the company immediately preceding the income year in which the dividend was paid up to the dividend payment date [s RG 5]. This is a concessionary provision applying where the company has ceased to hold such an interest at the time of receipt of the dividend.

Where FDP is required to be deducted from a dividend paid in foreign currency, the dividend is converted into New Zealand currency at either its actual conversion rate (if that rate is an arm’s length market exchange rate) or else at the close of trading spot exchange rate that applies on the day the FDP deduction is required to be made (or, at the company’s election, at the corresponding rate for the next day) [s EX 21].

\((1)\) **Conduit tax relief company**

The FDP liability for a CTR company [see 215.20] is reduced by the following amount:

\[
\text{percentage of non-residents} \times \text{amount of FDP}
\]

Where:

“Percentage of non-residents” is the percentage of the company’s non-resident shareholders;
“Amount of FDP” is the FDP liability otherwise applicable.

Conversely, it is the intention of the CTR rules that a CTR company can attach FDP credits only to dividends paid to resident shareholders [see 670.170]. In this case it is the gross (ie pre-CTR reduction) amount of FDP liability that is debited to the BETA of such a company [see 670.305].

The date for ascertaining the percentage of non-resident shareholders is the last date, before the receipt of the foreign dividend subject to FDP, that the company paid a dividend to all shareholders (a listed company may instead use the record date of shareholders’ dividend entitlement), or alternatively the end of the second income year before the year of receipt by the company of the foreign dividend if that date is later. If a company with more than one class of shares pays a dividend to all members of each class in an income year, the company is treated as if it had paid a dividend to all its shareholders on the latest such dividend date.

The percentage of non-resident shareholders is the lowest of:

(a) The percentage of direct voting interests held in the company by non-residents at the relevant date;
(b) The percentage of direct market value interests held in the company by non-residents at the relevant date, if a direct market value circumstance exists; or
(c) If the company has different classes of shares, the percentage of total dividends payable on a liquidation of the company to which non-resident shareholders would be entitled.

Treasury stock is disregarded in this calculation. In determining direct voting or market value interests for a company with different classes of shares, the relevant date is the date (see above) at which it is treated as if it had paid a dividend to all its shareholders, and the company is treated as having the same shareholders for each class of shares as it had on the most recent date in that income year on which a dividend was actually paid to all shareholders of that class. The rules for determining residence set out in ss YD 9 and YD 11 [see 215.25] apply [s RG 7].

670.135 Payment of FDP deductions and loss offset [ss RA 6, RA 15]

Foreign dividend payment (FDP) deductions required to be made in a quarter are payable to Inland Revenue no later than 20 days after the end of the quarter. A quarter is a three-month calendar quarter, so that the respective due dates for FDP to be paid to Inland Revenue are 20 April, 20 July, 20 October, 20 January.

Late payment penalties apply [see 670.210].

Note: A dividend arising from an attributed repatriation [see 670.125] is deemed to arise six months after the end of the accounting period of the controlled foreign company (CFC) for which it is calculated [s CD 21].

A company may elect to offset an amount of tax loss against its FDP liability. This applies where the company:

(a) Has a net loss from a prior year that is available for carry forward and offset against its net income for the income year of payment of the dividend; or
(b) Believes on reasonable grounds that it will have a net loss for the year of payment of the dividend that may be carried forward and offset against its net income for the succeeding income year.

The effect of the election is to reduce any such net loss, as far as it extends, by the amount of the reduction in FDP payable divided by 30 per cent (the basic company income tax rate applicable for the tax year in which the dividend was paid) [s IA 3(2)(b)].

Written notice of the election must be given to the CIR by the due date of the FDP liability. In practice, this is done by filling in the loss offset panel in the Foreign dividend payment return (IR4F). The CIR has discretion to accept a late notice. This discretion is intended to allow the election to be deferred until such time as the UFTC for a foreign dividend (and hence the FDP liability) can be ascertained. However, see 670.210 regarding two-way interest payable on estimated FDP liabilities and the penalties regime.

Note: Although the company is then deemed to have paid the corresponding amount of FDP by the relevant due date [TAA, s 120R], no credit arises to the company’s foreign dividend payment account (FDPA) (or imputation credit account (ICA)) for the FDP liability satisfied by loss offset [see 670.155 and 670.30].
Similar provisions permit a loss company in the same group of companies to elect to reduce its net loss to meet the FDP liability of the company that receives the foreign dividend.

When a company elects to satisfy a FDP liability by reduction of losses, and it does not in fact incur a net loss or have a sufficient net loss for this purpose, the CIR may disallow the election for so much of the FDP as is considered appropriate. This could also apply where the electing loss company and the company that received the foreign dividend are members of the same group of companies for only part of a relevant income year, so that only part of the electing company’s net loss was available for offset against the net income of the company with the FDP liability [see 940.31]. The company whose FDP liability was reduced by the loss election is then liable to pay the amount of FDP resulting from the disallowance, plus any late payment penalty [see 670.210] running from the original due date.

670.140 Refund of FDP overpaid or paid by loss company [ss RA 19, RM 18, RM 19, RM 20, RM 21, OD 25]

(1) Refund for FDP overpaid by company
A company that has overpaid its foreign dividend payment (FDP) liability may obtain a refund. However, where the refund relates to FDP overpaid during a previous tax year, the amount of refund cannot exceed:

(a) In the case of a foreign dividend payment account (FDPA) company [see 670.145], the amount of credit balance in its FDPA at the end of the tax year preceding that in which the entitlement to the refund arises; or

(b) In the case of an imputation credit account (ICA) company that is not a FDPA company, the amount of credit balance in its ICA at the end of the tax year preceding that in which the entitlement to the refund arises; or

(c) Where the company has ceased to be resident, the amount of credit balance in its FDPA (if it was previously a FDPA company) or ICA (if it was not previously a FDPA company) that was cancelled out by a corresponding debit immediately before it ceased to be resident [see 670.35 and 670.160].

Where the company receives more than one refund during the same tax year, its entitlement to a later refund is determined by reducing the relevant FDPA or ICA balance above by the earlier refunds of FDP received [see 670.70] which discusses refunds of income tax [s RM 18].

Where an amount of overpaid FDP is not refunded to the company because of the restrictions above, it is credited against any other FDP liability of the company for any tax year, including a prior tax year. No debit or credit arises to the FDP account where an amount of tax paid in excess is credited against an amount of income tax or provisional tax payable by the company.

An entitlement to a FDP refund may also arise under s CD 50, in relation to FDP previously paid on a deemed dividend “attributed repatriation” that arose in relation to a loan from a controlled foreign company (CFC) that subsequently is repaid within five years, or gives rise (through debt forgiveness) to a dividend [see 270.20]. In this case, the relevant FDPA or ICA credit balance that applies to restrict the amount of any FDP refund is deemed to be increased by the amount of any prior debit to that FDPA or ICA for breach of shareholder continuity provisions [see 670.75], if the breach occurred after the date of the original FDP payment [s RM 19]. See also 670.70 for a similar provision relating to income tax refunds. Where FDP is refundable under s CD 50, but the full amount of refund is not paid to the company because of the s RM 20 restrictions, the amount not refunded is to be offset against any subsequent income tax or provisional tax or FDP liability of the company. See 670.35 and 670.160 for debits to the company’s ICA or FDPA that arise in these circumstances. Any remaining excess is retained by the CIR.

(2) Refund for FDP paid by loss company
A company that has paid FDP, but which has a net loss available, may be able to obtain a FDP refund by an election to reduce the net loss [s RM 21]. This applies where the company has a net loss which may be carried forward and offset against its net income for the year following that in which the FDP was paid, or where another company in the same group has a net loss which may be offset against the net income of the company for the year the FDP was paid. The company must have filed its income tax return for the year of the FDP.
payment, and the loss company (ie the company or its fellow group company) must have filed its income tax return for the year in which the net loss arose. The company must make written application for the FDP refund, and if a group company’s net loss is to be utilised, then that company must elect in writing to the CIR to do so.

Where this is done, the company that paid the FDP is entitled to a refund. However, the refund cannot exceed either the company’s FDPA credit balance at 31 March in the most recently ending tax year, or an amount equal to the net loss available multiplied by 30 per cent (the basic rate of income tax for companies).

Note: There can be no refund when the company does not maintain a FDPA. The company is also entitled to a refund of any late payment penalty imposed for its FDP payment.

When such a FDP refund is made, the net loss of the relevant company is reduced by an amount calculated by dividing the amount of refund by 30 per cent (the basic rate of income tax for companies).

Any FDP refund in excess of the proper amount can be recovered by the CIR from the company as if it were income tax payable by the company [TAA, s 165A].

(3) Refund for credit balance transferred to conduit tax relief account

If a credit balance in a company’s FDPA is transferred to its conduit tax relief (CTR) account at tax-year end because a debit balance exists in the CTR account [see 215.80], the company is entitled to a corresponding amount of refund [s OD 25]. Such a refund does not cause a debit to arise to the FDPA [see 670.160].

670.145 Election to maintain FDPA [s OC 1]

Like the imputation credit account (ICA) [see 670.20], the foreign dividend payment account (FDPA) of a company is a memorandum account, that may be used to record the company’s payments of foreign dividend payment (FDP) and the allocation to shareholders of the benefit of those payments. However, unlike the ICA, maintenance of a FDPA is optional. Only a FDPA company can attach FDP credits to dividends paid to shareholders. If an ICA company does not also maintain a FDPA, any FDP payments that it makes, or any FDP credits attached to dividends that it receives, are credited instead to its ICA and result only in imputation credits to its shareholders. FDP credits in excess of the tax liability of a shareholder are, unlike imputation credits, refundable to the shareholder. For example, a company is likely to wish to maintain a FDPA if it has significant non-resident shareholders who would benefit from FDP refunds in excess of their non-resident withholding tax (NRWT) liability [see 670.185].

Any resident company can elect to maintain a FDPA for an tax year (eg by way of directors’ resolution to do so). Written notice of the election must be given to the CIR within 21 days of election date, or within such further time as the CIR may allow. A company that elects to maintain a FDPA must do so for the period from election date, and thereafter during every subsequent tax year until it ceases to be a FDPA company (eg on liquidation).

However, a company may, in a subsequent tax year, elect to cease to be a FDPA company, with effect from the start of the next succeeding tax year. This means that when a company elects to maintain a FDPA, it must continue to do so for at least the remainder of the tax year of the election and the following tax year. An election to cease to maintain a FDPA has no effect unless the company files its annual FDP return for the tax year of election within the time allowed for filing its annual income tax return and pays any further FDP that is payable for that year [see 670.200].

670.150 Information to be recorded in the FDPA [ss OA 2, OA 3, OA 7]

(1) Repeal of FDP rules

Several sections in subpart OC that give rise to FDP credits have been repealed as these sections are redundant with the repeal of the FDP rules in subpart RG for income years beginning on or after 1 July 2009.

Sections OC 6, OC 8, OC 9, OC 10, OP 56, OP 61 and OP 62 have been repealed to prevent new FDP credits from being generated.
Previous rules
The foreign dividend payment account (FDPA) must record for each tax year the 1 April opening balance for the year and credits and debits to the account as they arise. The rules in this regard, including the power of the CIR to correct any entry or omission [s OA 2(5); TAA, s 104B], are essentially the same as for the imputation credit account (ICA) [see 670.25]. For record keeping requirements [see 670.80].

670.155 Credits to the FDPA [Table O3]
Table O3 summarises the credits in a FDPA, the date the credit arises and the section reference pertinent to the credit. The table needs to be read in conjunction with the appropriate section, Table O3 features in the ITA 2007 after s OC 37. Each of the following transactions shall be stated in the FDPA. The row numbers are the same as those stated in Table O3 of the legislation.

1. **Opening credit balance**: The opening credit balance is the previous year’s closing balance if that was a credit balance. The ICA rules refresh this credit on first day of the tax year (ie 1 April irrespective of the balance date for the company) [s OA 7].

2. **FDP paid**: To be credited on the day of payment [s OC 6].

3. **Further FDP paid**: To be credited on the day of payment [s OC 6].

4. **FDP credit attached to dividend derived**: A credit arises for any FDP credit attached to a dividends paid to the company. The credit arises on the date that the dividend is paid [s OC 9].

5. **FDP paid on transfer from CTRA**: If the company maintains a CTRA, any amount of FDP that becomes payable under s OD 23 where a credit balance is transferred at the tax-year end from its CTRA to its FDPA on account of a year end debit balance in the FDPA [see 670.215]. The credit arises on 31 March [s OC 8].

6. **Transfer from ICA on account of net foreign attributed income for income year**: This refers to any amount debited to the company’s ICA on account of the company’s income tax liability on foreign attributed income [see 670.35]. The credit arises on the corresponding debit date in the ICA [s OC 9].

**Note**: The amount transferred from the ICA to the FDPA could be less than the actual income tax payable on foreign attributed income, as in the example below.

**Example**: A company that is 40 per cent owned by non-resident shareholders derives foreign attributed income of $5,000. An excess interest allocation of $2,000 is determined for the company under subpart FF [see 215.95]. It has no foreign attributed losses, CFC tax credits, or BETA debit balance offsets for its foreign attributed income, for the purpose of calculating the debit to its ICA and corresponding credit to its FDPA. The company does not maintain a CTR account. Income tax paid on the foreign attributed income is 30 per cent of $5,000, or $1,500. However, the amount to be transferred from the ICA to the FDPA is 30 per cent of ($5,000 – $2,000), or $900 [see 670.35, and the formula set out in ss LQ 1 and LQ 2]. The balance of $600 of actual income tax paid on the foreign attributed income remains as a credit in the ICA.

7. **FDP paid for debit balance in company’s CTRA**: If the company maintains a CTRA, this applies to any amount of FDP paid by the company under s OD 23, as a consequence of the cancellation of certain CTRA credits where the company ceases to be a CTR company, or where the company ceases to be a CTR group member for another CTR company or vice versa [see 670.215]. The credit arises in each case on the date that the FDP is paid [s OC 10].

8. **FDP attached to dividend and shown in credit transfer notice**: Credit transfer notices arise under the rules applying to share lending transactions [see 1340.90]. The credit arises on the day on which notice is given [s OC 11].

9. **Reversal of debt for tax advantage arrangement**: This applies to any amount previously debited to the FDPA for an arrangement to obtain a tax advantage [see 670.115], where it is subsequently established (eg by the CIR or a Court), that the CIR ought not to have done so. The credit arises on the same date the previous debit arose [s OC 12].

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No FDPA credit arises where FDP is paid by reducing a net loss. No debit or credit arises to the FDPA account where an amount of tax paid in excess is credited against an amount of income tax or provisional tax payable by the company.

670.160 **Debts to the FDPA** [Table O4]

Table O4 follows Table O3 in the ITA 2007 after s OC 39. Each of the following transactions refers to an explanation of the FDP debits that shall be stated in the FDPA and the date when the entry should be made. The row numbers are the same as those stated in Table O4 of the legislation.

1. **Opening debit balance**: The opening debit balance is the previous year’s closing balance if that was a debit balance. The FDP rules refresh this debit on first day of the tax year; (ie 1 April) irrespective of the balance date for the company [s OA 7].

2. **FDP credit attached to dividend paid**: A debit arises for the amount of FDP credit attached to a dividend paid by the company. The debit arises on the date the dividend is paid [s OC 13].

3. **Refund of FDP**: This applies to overpaid FDP refunded to the company during the year. However, this does not apply to the extent that a debit to the FDPA for breach of shareholder continuity requirements (see row 12 below) has already arisen after the date that the FDP was originally paid by the company. This is to prevent double debiting of the FDPA for the same amount of FDP. Similarly, no debit arises for a refund that the company becomes entitled to because of any year end transfer to its CTRA. The debit arises on the day of refund [s OC 14].

4. **Overpaid FDP applied to satisfy tax liability**: This applies to overpayments of FDP that the CIR applies to satisfy some tax liability of the company other than FDP (eg an income tax or provisional tax or GST liability). This does not apply to the extent that the amount applied does not exceed the amount of a previous debit to the FDPA for breach of shareholder continuity, if the overpaid FDP was paid before the date of that previous debit. The debit arises on the date that the CIR applies the overpaid FDP [s OC 15].

5. **Any tax refund to the company for FDP credits attached to dividends it receives (ie as a shareholder)**: The debit arises on the day of refund [s OC 16].

6. **FDP attached to dividend and shown in credit transfer notice**: Credit transfer notices arise under the rules applying to share lending transactions [see 1340.90]. The debit arises on the day of payment [s OC 17].

7. **Transfer of closing credit balance to company’s ICA**: This applies to the amount of the credit balance at the end of the tax year that the company elects to credit to its ICA [see 670.165]. The debit arises on 31 March [s OC 18].

8. **Transfer of credit balance to company’s CTRA**: If the company maintains a CTRA this applies to the amount of any credit balance in the FDPA that becomes transferable at the end of the tax year to the CTRA on account of a year end debit balance in the CTRA (in which case the company becomes entitled to a refund of the amount transferred [see 670.140]. The debit arises on 31 March [s OC 19].

9. **Transfer of credit balance to company’s PCA**: This applies to an amount of the credit balance in a life insurance company’s FDPA that the company elects under s OC 20 to credit to its PCA [see 800.50]. The debit to the FDPA and credit to the PCA arise on the date that the company elects to do so by recording the entries in these memorandum accounts [s OC 20].

10. **Transfer of credit to group FDPA**: This applies when an FDPA company has an FDP debit equal to the amount of an FDP credit under s OP 59 for transfer to the FDP of a consolidated group. The debit arises on the credit date in group account [s OC 21].

11. **Debit for breach of FDP ratio**: This applies to the allocation deficit debit that arises when the FDP ratio of a subsequent dividend differs from that of the benchmark dividend [see 670.175]. The debit arises on 31 March [s OC 22].
12 Breach of FDP ratio by FDPA company that is also a PCA company: This is the allocation deficit debit that arises for a life insurance company that is a PCA company, when the FDP credit transfer fraction for any transfers of credits from its FDPA to its PCA is less than the imputation credit transfer fraction for any transfers of credits from its ICA to its PCA [see 670.180]. The debit arises on 31 March [s OC 23].

13 Debit for loss of shareholder continuity: This applies to any credits existing in the FDPA (and not cancelled by a prior or subsequent debit) at any time where there is a breach of shareholder continuity [see 670.195]. The debit arises on the day of loss of continuity [s OC 24].

14 Debit for tax advantage arrangement: This is a further debit that may be imposed under the anti-avoidance provisions [ss GB 35 and GB 36], where the CIR determines that there is an arrangement to obtain a tax advantage [see 670.115]. The debit arises on the last day of the tax year in which the arrangement began [s OC 25].

15 Final balance when FDPA status ends: This cancels any credit balance in the FDPA if for any reason the company ceases to be a FDPA company (eg on ceasing to be resident or on winding up). The debit arises immediately before the company ceases to be a FDPA company, so that any credit balance in the FDPA is extinguished at that time [s OC 26].

670.165 Transfers from the FDPA to the ICA [s OC 18]

A company that has a foreign dividend payment account (FDPA) credit balance, either at the end of any tax year or immediately before a debit to the FDPA arises under s OC 26 when it ceases to be resident, can elect to transfer all or part of that credit balance to its imputation credit account (ICA). The company does so by recording a debit in the FDPA and a credit in the ICA, with effect from the relevant date in each of the above situations. For example, it may wish to do so to clear or reduce a 31 March ICA debit balance [see 670.95], or immediately prior to any liquidation when the foreign dividend payment (FDP) credits will otherwise be lost [see 670.36].

Note: A conduit tax relief (CTR) company cannot transfer credits from its FDPA to its ICA.

670.170 Attaching FDP credits to dividends [s OC 27]

A foreign dividend payment account (FDPA) company can attach a foreign dividend payment (FDP) credit to a dividend, should it choose to do so, on payment of the dividend [s OC 27], subject to the rules set out below that apply to dividends paid to non-resident shareholders of a conduit tax relief (CTR) company. If it does so, the total of the dividend paid plus the attached FDP credit (plus any imputation credit) will be included in the shareholder’s income [see 670.185]. As for imputation credits, the company is free to determine the amount of FDP credit attached, subject to allocation rules as to maximum permissible credits and benchmark dividends [see 670.175].

It is suggested that, as for imputation credits, the company’s decision to attach the FDP credit should be included in its resolution to pay the dividend.

Like the imputation credit account (ICA), the FDPA does not have to be in credit at the time that a debit arises for FDP credits attached to dividends, so that the company can anticipate payments of FDP liability after that date. However, a debit balance remaining at 31 March tax-year end is subject to further FDP liability and penalties [see 670.200].

Any dividend (including non-cash dividends) that arises for income tax purposes to which an imputation credit could be attached will also be a dividend to which a FDP credit can be attached [see 670.40].

1 Conduit tax relief company

The CTR rules [see 215 CONDUIT TAX RELIEF] are intended to restrict the attaching of FDP credits by a CTR company to dividends paid to its resident shareholders, with CTR credits instead being attached to dividends paid to its non-resident shareholders. Under s OC 27, a FDPA company that also maintains a CTR account cannot attach FDP credits to dividends paid to non-resident shareholders.
670.175 Allocation rules for FDP credits [ss OA 18, OC 27, OC 28, OC 29]

The two allocation rules contained in ss OC 27 to OC 29 essentially parallel those applying to imputation credits [see 670.45]. They apply by placing identical restrictions on the foreign dividend payment (FDP) ratio of a dividend (ie the ratio of the amount of attached FDP credit to the amount of dividend paid — exclusive of the FDP credit or any imputation credit).

Accordingly, the first allocation rule [s OA 18] is that the FDP ratio cannot exceed the 30/70 maximum fraction (based on the current rate of basic income tax for companies) that applies for imputation purposes. If it does, then as for imputation credits, the excess FDP credit attached to the dividend is not allowed as a credit of tax and is excluded from the amount of dividend [see 670.55]. However, the full amount of FDP credits attached is still debited to the company’s foreign dividend payment account (FDPA), so that the excess amount is effectively forfeited.

The second allocation rule, as for imputation credits, requires every subsequent dividend paid by the company during a tax year to have the same FDP ratio as that of the benchmark dividend, unless both of the following are satisfied [s OC 28]:

(a) A ratio change declaration [see 670.45] is filed with Inland Revenue before the date of payment of the subsequent dividend, or before such later date as the CIR may allow; and

(b) The subsequent dividend is not paid as part of an arrangement to obtain a tax advantage [ss GB 35, GB 36, see 670.115].

Non-cash dividends may have benchmark dividend implications [see 670.45].

On breach of the second allocation rule, an allocation deficit debit arises [s OC 22] to the FDPA, of an amount that is calculated (with the substitution of FDP credit for imputation credit) in exactly the same way as an allocation debit for imputation credits [see 670.45]. That is to say, the allocation deficit debit is effectively the difference between the total amount of FDP credits actually attached to dividends paid during the tax year, and the total amount of FDP credits that would have been attached if all such dividends had FDP ratios equal to the highest FDP ratio (not exceeding 30/70) that was actually adopted. The allocation deficit debit arises at the 31 March tax-year end, so that it might cause a FDPA debit year end balance to arise with consequential further FDP liability and penalties.

These two rules do not apply to statutory producer boards and co-operative companies [see 670.85, 670.90].

A third allocation rule [s OA 18] applies where the company pays a dividend with both imputation and FDP credits attached. The combined imputation and FDP ratio (ie the ratio of the total of attached imputation and FDP credits to the amount of dividend paid) cannot exceed the 30/70 maximum fraction. If it does, the excess credit amount is calculated under s OC 29, based on the difference between that ratio and the 30/70 maximum permissible figure. This amount is then applied [s LJ 1(3)] to reduce the credits of tax available to the shareholder, in such a way that FDP credits are lost first [see 670.55]. As the full amounts of imputation and FDP credits attached are still debited to the company’s imputation credit account (ICA) and FDPA respectively, the credits represented by the excess credit amount are effectively forfeited.

These allocation rules, and the definitions of FDP ratio and combined imputation and FDP ratio, also apply under the conduit tax relief (CTR) rules [see 215.75] as if a CTR credit attached to a dividend was a FDP credit [ss OA 18, OD 20, OD 22]. However, to the extent that an allocation deficit debit arises only through a CTR credit being so treated as if it was a FDP credit, the allocation deficit debit is debited to the company’s CTR account [see 215.60], not to the FDPA [s OD 21].

670.180 Allocation deficit debit for life insurance company [s OC 20]

A different kind of foreign dividend payment account (FDPA) allocation deficit debit can also arise where a life insurance company that is a policyholder credit account (PCA) company also maintains a FDPA, and transfers credits from its imputation credit account (ICA) and its FDPA to the PCA [see 800.50]. If the insurer is also a CTR company it cannot transfer credits from its FDPA to its PCA [s OC 20]. The debit arises when, for an tax year, the company’s FDP credit transfer fraction is less than its imputation credit transfer fraction.
Anti-avoidance rules that apply to prevent the streaming of credits are made up of:

(a) An allocation deficit debit to the FDPA;
(b) An imputation credit transfer fraction; and
(c) A FDP credit transfer fraction.

An allocation deficit debit arises when the “shareholder FDP ratio” exceeds the “policyholder FDP ratio” in a “FDP reference period”. The “shareholder FDP ratio” is the total FDP credits divided by the total dividends paid. The “policyholder FDP ratio” is the total of the FDP credits transferred to the policyholder credit account divided by the net policyholder income. The FDP reference period is the current tax year plus previous years since the date on which a dividend with FDP credits attached was last paid. The objective of the measure is to ensure that the ratio by which FDP credits are attached to shareholder dividends does not exceed the equivalent ratio for policyholders.

Where an allocation deficit debit arises in the FDP account, a corresponding credit arises in the policyholder credit account to the extent to which the FDP account has a credit balance.

Shareholder income and FDP tax credits and refunds [ss CD 15, LA 6, LF 8, OC 1(5), (6)]

As for an imputation credit [see 670.50], the amount of dividend derived by a resident taxpayer includes the amount of foreign dividend payment (FDP) credit attached to the dividend [s CD 15]. For non-resident withholding tax (NRWT) purposes, the amount of a dividend paid to a non-resident taxpayer also includes the amount of any FDP credit attached. The taxpayer obtains a credit of tax for the FDP credit [s LF 1]. However, the amount of FDP credit that applies in particular circumstances is modified by the provisions of s LB 1 [see 670.55]. As for imputation credits, the taxpayer is required to furnish the shareholder dividend statement [see 670.60] or other written evidence of the FDP credit to Inland Revenue [ss LF 10; TAA, 78D].

The FDP tax credit is credited against a resident shareholder’s income tax liability, after first crediting imputation credits, any foreign tax paid (eg NRWT), and resident withholding tax (RWT) credits [s LA 6]. Any excess FDP tax credit not utilised in this way is refundable, unlike imputation credits.

Note: Refundable credits (RWT and FDP) are offset last against income tax liability. Because of the ordering rule above, a company receiving a refund can determine what part of the refund comprises RWT (debited to the imputation credit account (ICA)) or FDP (debited to the foreign dividend payment account (FDPA)).

Part or all of a FDP credit may be disallowed in similar circumstances to those applying for imputation credits [see 670.50].

A non-resident shareholder is entitled to a refund of FDP credits in excess of NRWT imposed on the dividend. The amount of FDP credits attached to the dividend is included in the dividend amount on which NRWT is calculated, and the amount of FDP credits utilised to meet the NRWT liability is deemed to be NRWT paid [see 1020.20], so that the company paying the dividend reduces its NRWT payment to Inland Revenue accordingly. The balance of the amount of FDP credits is refundable. For this purpose, the amount of FDP credits (prior to NRWT offset) cannot exceed the amount that would be included in income if the shareholder was resident in New Zealand [see 670.55], so that any over-allocated FDP credits are not refundable.

The non-resident shareholder must apply annually to Inland Revenue to obtain the refund, no earlier than 31 May following tax-year end [TAA, s 78D], in a form authorised by the CIR (form IR3NR or an income tax return). The shareholder dividend statement, or other satisfactory evidence of the FDP credit refundable, must be supplied.

However, for a non-resident shareholder of a CTR company, the CTR rules preclude the attaching of FDP credits to dividends paid from 1 April 1998, subject to transitional rules applying to dividends paid [ss LF 8, OC 1(6), see 670.170].
670.190 Annual and other FDPA returns [TAA, ss 71, 72]
An annual foreign dividend payment account (FDPA) return in the prescribed form (IR4D) must be filed by a FDPA company following each tax year, within the period allowed for filing the income tax return for the company’s corresponding income year [TAA, s 71]. The FDPA return must show:
(a) The opening and closing balances of the FDPA for the tax year;
(b) The amount and source of all debits and credits that have arisen during the tax year;
(c) The amount of any further FDP payable [see 670.200];
(d) Any FDP penalty tax payable [see 670.205];
(e) Whether the company has elected to cease to be a FDPA company;
(f) The amount and source of every foreign withholding payment dividend paid to the company during the year, and the amount of any foreign withholding tax paid for each such dividend; and
(g) Such other information as the CIR may prescribe or require.
Other circumstances where a FDPA return is to be furnished [TAA, s 72] are where the company ceases to be resident in New Zealand (in which case it must furnish a return for the period up to cessation date within two months of the cessation date, as for its ICA return [see 670.65], or as and when required by the CIR for any specified period.)

670.195 FDPA shareholder continuity requirements [s OC 24]
For a foreign dividend payment account (FDPA) company to continue to carry credits in its FDPA, it must satisfy the 66 per cent shareholder continuity provisions contained in s OC 24. If it does not do so, a debit to the FDPA arises at the time that the shareholder continuity provisions are breached [see 670.160], that extinguishes credits in the FDPA at that time that have not been cancelled out by a (prior or subsequent) debit. Accordingly, any FDPA credit balance is effectively lost at the time of a breach of the shareholder continuity provisions.
The FDPA 66 per cent shareholder continuity requirements are identical to the imputation credit account (ICA) shareholder continuity requirements [see 670.75].
Note: As for the ICA, a credit to the FDPA can be cancelled by a prior debit (ie not just by a subsequent debit), before the time of any breach of shareholder continuity.

670.200 Further FDP for company with FDPA debit balance at year end or on ceasing to be resident [ss OC 30, OC 31, OC 32, OC 33, OC 34]
(1) Repeal of FDP rules
The foreign dividend payment (FDP) rules have been repealed in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009, from income years beginning on or after 1 July 2009. Foreign dividend payment accounts will be gradually phased out.
During the phase out, if a company has an FDP debit at the end of the tax year [s OC 30] or when it migrates offshore [s OC 31], “further FDP” was payable under the previous rules. This liability has been replaced with a liability to pay further income tax. Sections OC 4, OC 5, and OC 30 to OC 34 have been amended to replace “further FDP” with “further income tax.”
Consistent with this change, s 140B of the TAA has been amended so that imputation penalty tax is payable when further income tax is payable under s OC 30.
(2) Previous rules
Further foreign dividend payment (FDP) is an amount of FDP liability that is imposed if the foreign dividend payment account (FDPA) has a debit balance at 31 March or when the company ceases for any reason to be resident (eg on liquidation). It is payable by the following 20 June for a company with a 31 March FDPA debit balance, and by the date of ceasing to be resident for a company that has a FDPA debit balance at that date [s OC 30]. The amount of further FDP is the amount of the debit balance.
Further FDP paid can be credited against any FDP liability of the company arising after its payment [s OC 34]. Payment of further FDP gives rise to a FDPA credit, on the date it is paid [s OC 33]. However, payment of a subsequent FDP liability by way of a crediting of further FDP previously paid does not give rise to a subsequent FDPA credit [s OC 1]. It is not refundable to the company.

In addition, where a company has a 31 March FDPA debit balance, FDP penalty tax (also payable by 20 June) of 10 per cent of the further FDP is also imposed (although not where a company has a FDPA balance on ceasing to be resident).

A further amount of FDP may also become payable by a CTR company in certain circumstances when debits to its CTR account arise [see 670.215].

A company that has a debit balance in its FDP account at the end of the tax year may apply in writing to the CIR for a reduction in liability if the company had a debit balance in its FDP account at the end of the immediately preceding tax year and that debit balance exceeds the total of FDP payments that the company has made during the tax year [s OC 32].

670.205 FDPA penalties and use of money interest [TAA, ss 120D, 139B, 140C]

(1) Repeal of FDP rules

The foreign dividend payment (FDP) rules have been repealed in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009, from income years beginning on or after 1 July 2009. Foreign dividend payment accounts will be gradually phased out.

Consistent with this change, s 140B of the TAA has been amended so that imputation penalty tax is payable when further income tax is payable under s OC 30. Section 140C of the TAA has been repealed.

(2) Previous rules

Foreign dividend payment (FDP) penalty tax applies under the penalties regime [TAA, s 140C]. The penalty tax is 10 per cent of the amount of any further FDP liability for a 31 March FDPA debit balance. It is payable by the following 20 June.

If further FDP and the 10 per cent FDP penalty tax (of more than $100) are not paid by 20 June, late payment penalties [TAA, s 139B] of an initial five per cent and two per cent per month thereafter (compounding) will apply [see 1110.40].

These provisions parallel those that apply to further income tax for a 31 March ICA debit balance. Use of money interest provisions [TAA, s 120D] where payments are made after due dates, and other general penalties, also apply in the same way as for the imputation provisions [see 670.105].

There are three situations where the CIR is required to remit FDP penalty tax relating to a 31 March FDPA debit balance [TAA, s 181]:

(a) To the extent that the debit balance arose through the CIR debiting the FDPA in reliance on the ss GB 35, GB 36 anti-avoidance provisions, but that debit has subsequently been reversed [see 670.30];

(b) To the extent that the debit balance arose from a FDP refund having been sent but not received, or not known by the company to have been received, before 31 March; and

(c) To the extent that the debit balance arose because overpaid FDP was applied by the CIR against some other tax liability of the company or of a consolidated group, and the taxpayer was not aware of this in sufficient time to clear the 31 March FDPA debit balance position.

As for the corresponding imputation provisions, in these situations the CIR must also remit any corresponding late payment penalty that has arisen for the FDP penalty tax, and in situation (a) only, any late payment penalty on the corresponding amount of further FDP. The CIR similarly has discretion to remit FDP penalty tax or a late payment penalty for reasonable cause [see s 183A of the TAA and 670.105].
The s 120D (TAA), (two-way) use of money interest provisions, and penalties for late payment or underpayment, also apply to a company’s quarterly payments of FDP to the CIR [see 670.210].

**670.210 Two-way use of money interest and penalties on FDPs** [TAA, s 120D]

FDP deductions must be paid quarterly to the CIR [see 670.135]. However, companies may be forced to estimate FDP liabilities because details of the underlying foreign tax credit (UFTC) are not then available [see 670.230].

Any underpayments and overpayments of FDP are subject to the same use of money interest rules [TAA, s 120D] that apply to underpayments and overpayments of tax liabilities generally [see 1110.295]. Late payment penalties [TAA, s 139B] can apply in addition to interest, subject to the ability of the CIR to remit such a penalty for reasonable cause [see 670.105], and shortfall penalties [see 1110.185] are also potentially applicable.

Where a company elects to offset losses against a FDP liability [see 670.135], for the purpose of the s 120D of the TAA interest provisions a payment of the relevant amount of FDP is deemed to have been made by the required due date [TAA, s 120R]. TIB vol 8.7 (October 1996) at 7 states that this applies if the company’s notice of election is given to the CIR by the quarterly due date for the FDP liability. However, where the CIR accepts a late election [see 670.135], the s 120R (TAA) provisions appear to apply similarly.

**670.215 Further FDP payable for debits to conduit tax relief account** [s OD 23]

Under the conduit tax relief (CTR) rules, further amounts of FDP become payable by a CTR company under s OD 23, in the various circumstances (other than when the company attaches CTR credits to a dividend paid) where a debit arises to the company’s CTR account [see 215.60, 215.80].

In the following circumstances, the company must pay a further amount of FDP equal to the CTR account debit to the CIR within 20 days of the end of the quarter in which the debit arises and the payment of the further amount of FDP does not give rise to a credit to the company’s FDPA:

(a) Where an allocation deficit debit arises to the CTR account under s OD 17 [see 670.175];
(b) Where a further debit arises to the CTR account under s OD 18, as a consequence of the application of the ss GB 35, GB 36 anti-avoidance provisions [see 670.115]; and
(c) Where a debit to the CTR account arises under s OD 16 due to the company’s percentage of resident shareholders having increased by 34 per cent or more since a CTR account credit arose [see 215.60].

In the following circumstances, the company must similarly pay an amount of FDP equal to the CTR account debit to the CIR within 20 days of the end of the quarter within which the debit arises. However, such payments of FDP give rise to credits to the company’s FDPA [see 670.155]:

(a) Where a debit to the CTR account arises under s OD 14 to cancel a credit that had arisen under ss LQ 1 and LQ 2 the CTR rebate or the s RG 7 reduction in FDP liability provisions due to the deemed non-resident status of a CTR group member, and that status ceases to apply because a non-resident ceases to hold the direct voting interest or market value interest required under s YD 11 in the CTR group member or in another member of the same wholly-owned group [see 215.60];
(b) Where a debit to the CTRA arises under s OD 15 to cancel a credit that had arisen because the company was a CTR group member when it received a dividend with a CTR credit attached from another CTR company, and the company ceases to be a CTR group member for that other company because of a cessation of shareholding by a non-resident as in (a) above [see 215.60]; and
(c) Where the CTR account debit arises under s OD 19 because the company ceases to be a CTR company [see 215.60].

If a credit balance is transferred from the company’s CTR account to its FDPA at tax-year end under s OD 11 [see 215.80], the company must pay an amount of FDP to the CIR equal to the amount transferred.
670.220 Foreign dividend payment anti-avoidance provisions [ss GB 39, GB 41]

The general FDP anti-avoidance provision s GB 39 applies to an arrangement that the CIR considers has been entered into between persons with a purpose (not necessarily its sole or dominant purpose) of avoiding the application of the FDP rules. Where this applies, the CIR may deem part or all of a payment under the arrangement to be a foreign dividend payment subject to FDP deduction.

FDPA shareholder continuity anti-avoidance rules are contained in s GB 41, which parallel those in s GB 34 [see 670.75] for ICA shareholder continuity.

The imputation anti-avoidance rules contained in ss GB 36 and GB 37, that are aimed at preventing the streaming of credits to shareholders, also apply for FDP purposes [see 670.110, 670.115].

670.225 Offences relating to FDPs

See 1110.230 and 1110.235 for offences relating to failures to make a deduction required to be made by a tax law.

670.230 Underlying foreign tax credits

(1) Repeal of FDP

Following the exemption for most foreign dividends received by companies in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009, from income years beginning on or after 1 July 2009, the foreign dividend payment (FDP) rules have been repealed.

Subpart LL has been consequentially repealed for income years beginning on or after 1 July 2009.

(2) Previous rules

The “underlying foreign tax credit” (UFTC) regime in subpart LL allows a company (other than a qualifying company) to reduce its FDP liability on foreign dividends received by taking into account tax paid by the foreign company on its earnings, provided the company has a “sufficient interest” (10 per cent or more) in the foreign company and certain other requirements are met [see 670.235, 670.240].

If the foreign dividend-paying company is resident in a grey-list country (currently Australia, Canada, Germany, Japan, Norway, Spain, UK, and USA [see 850.15]), the UFTC is a notional amount intended to eliminate the company’s FDP liability on the dividend. In this case, the company must maintain a “tracking account” to determine its entitlement for a full deemed-tax paid UFTC. The tracking account is a memorandum account that operates as an anti-avoidance device, to prevent dividends from non-grey-list companies being routed through grey-list companies to qualify for the full deemed-tax paid UFTC [see 670.255]. Otherwise, the UFTC is calculated based on actual tax paid by the foreign company [see 670.245].

Where the company does not qualify for a full deemed-tax paid UFTC to reduce its FDP liability to nil, provision is made for the UFTC available to include tax paid by a “lower tier” company in which the foreign dividend-paying company in turn has a shareholding, if that lower tier company has paid a dividend to the foreign dividend-paying company and the resident company has a required interest in both of those other companies at that time [see 670.270]. This means that foreign tax credits can effectively be passed up a chain of companies for UFTC purposes, through the payment of dividends from lower tier companies.

Various information requirements apply under the UFTC regime [see 670.275], for tracking account details (if applicable), evidence of foreign tax paid, and foreign company details relating to years prior to the introduction of the regime.
The regime also contains anti-avoidance provisions limiting the deductibility of interest paid offshore by the resident company under certain conduit financing arrangements, where in turn a dividend is received by the resident company from a grey-list company [see 670.280].

670.235 Eligibility requirements for underlying foreign tax credits [ss LL 2, LL 9]

An underlying foreign tax credit (UFTC) can only arise for a dividend for which there is a FDP liability (ie for a “foreign withholding payment dividend”) [see 670.125]. However, no UFTC is available for the taxpayer company receiving the dividend where:

(a) At that time, the taxpayer is a qualifying company;
(b) At that time, the taxpayer does not have a “required interest” [see 670.240] in the dividend-paying company; or
(c) The dividend is paid on a fixed rate share [s LL 9] (or if a fixed rate share is taken into account in calculating a dividend that is an attributed repatriation);
(d) The dividend-paying company can claim a deduction for the dividend in calculating its foreign income tax liability;
(e) From 21 December 2004, if as a result of paying the dividend, the company has no income tax liability in relation to an amount from which the dividend was sourced; or
(f) The dividend was sourced by the dividend-paying company, directly or indirectly, out of an amount that it derived from another company, and:
   (i) The dividend-paying company was not subject to foreign income tax on that amount; and
   (ii) That other company could claim a deduction for foreign income tax purposes for that amount.

670.240 Required interest in dividend-paying company [ss LL 1, LL 9]

No underlying foreign tax credit (UFTC) is available to offset the FDP liability of a resident company that receives a foreign dividend unless the company has a “required interest” in the dividend-paying company at that time. Furthermore, the period or periods for which the New Zealand company holds such a “required interest” in the dividend-paying company determine which accounting years of the dividend-paying company qualify as “eligible accounting years” [see 670.250], for the purpose of calculating the UFTC entitlement.

A company has a required interest in another company at a particular time only where:

(a) It has at that time a voting interest of 10 per cent or more in that other company, determined solely for its right to appoint or elect directors of that company. For this purpose, the normal tracing rules [s YC 4(1)-(3)], whereby the company is deemed not to hold those voting interests that are attributed to its shareholders, do not apply (ie all its voting interests are counted); and
(b) If a market value circumstance exists at that time for that other company, it also has at that time a market value interest of 10 per cent or more in that other company, again determined without applying the normal tracing rules that would otherwise exclude those market value interests that are attributed to its shareholders; and
(c) The other company must be at that time:
   (i) A CFC; or
   (ii) A foreign investment fund (FIF) for which the resident company is using the branch equivalent method to calculate FIF income or loss; or
   (iii) Resident in a grey-list country [see 850.15]; or
   (iv) A company resident in New Zealand that is not a company that is treated as not being resident in New Zealand under a double tax agreement. (This enables a resident company to hold a sufficient interest in another resident company, which is relevant where the other resident company is a lower tier company [see 670.270]); or

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(d) The company has an income interest of 10 per cent or more in the other company, and the other company is a CFC.

From 1 April 2006, companies that invest in “foreign hybrids” are able to receive “grey-list” treatment and foreign tax credits for tax paid overseas on income earned by a foreign hybrid that is either a controlled foreign company (CFC) or a branch-equivalent foreign investment fund (FIF). The underlying foreign tax credits and deemed underlying foreign tax credits are able to be used to offset the foreign dividend payment.

A foreign hybrid is an entity that has the characteristics of both a company and a partnership. It is treated as a company for New Zealand tax purposes, but is treated like a partnership (with “flow-through” tax treatment) or a branch of the parent company under another country’s tax system. A foreign hybrid that is a CFC does not pay the foreign tax because the tax is imposed on its members. Certain conditions apply to the treatment of foreign hybrids as grey-list CFCs [see 850.20, TIB vol 18:5 (June 2006) at 115-116].

670.245 Type of underlying foreign tax credit available [ss LL 2, LL 9]

The type of underlying foreign tax credit (UFTC) available depends on whether the foreign dividend is paid by a company that is resident in a grey-list country.

If it is, then, subject to certain conditions being met, the UFTC is calculated under s LL 3, and is a notional amount intended to eliminate FDP liability. This is based on the presumption that the foreign company will have paid tax in that country equal to New Zealand tax on its earnings from which the dividend is sourced [see 670.255].

However, if the foreign company is not resident in a grey-list country, or in any case where the conditions are not met, then the UFTC is calculated based on actual tax paid on its earnings by the foreign company, under ss LL 2 and LL 5 [see 670.265].

In either situation, it is necessary to determine which accounting years of the foreign company are, “eligible accounting years” in relation to the particular dividend. Such years may effectively determine the UFTC entitlement for a particular dividend.

670.250 Eligible accounting year [s YA 1]

An eligible accounting year is defined in relation to each dividend paid by the foreign company to the resident company, and by reference to “accounting years” [s YA 1] (the periods for which accounts are prepared) of the foreign company.

An eligible accounting year is an accounting year of the foreign company during which the resident company has at all times held a required interest in the foreign company, and which is either:

(a) The accounting year in which the dividend is paid;
(b) The immediately preceding accounting year; or
(c) An accounting year immediately preceding an eligible accounting year.

The simplest way to determine eligible accounting years in relation to a dividend is to first establish which of the year the dividend is paid or the immediately preceding accounting year, is the latest year during which required interest has been maintained throughout by the resident company. That year, and all preceding years during which required interest has been maintained, will be eligible accounting years.

Example:

A resident company obtained a required interest of 25 per cent in a foreign company on 28 December 20X1. The foreign company has a 31 May balance date, and paid a dividend to the resident company on 30 June 20X5. The accounting year ending 31 May 20X6 will be an eligible accounting year for that dividend only if the required interest continues to be held throughout that year. The preceding accounting years ending respectively on 31 May 20X5, 31 May 20X4, and 31 May 20X3 are eligible accounting years. The accounting year ending 31 May 20X2 is not an eligible accounting year, as required interest was not held throughout that year.
670.255 Underlying foreign tax credit for dividends from grey-list companies [ss LL 2, LL 3]

Subject to certain requirements being met, the intention of the s LL 2 provisions is to provide, in respect of a dividend paid from a grey-list jurisdiction, an underlying foreign tax credit (UFTC) equal to the amount of the FDP liability otherwise applicable. Accordingly, there will generally be no FDP liability on dividends sourced from grey-list companies.

The amount of the UFTC arising for such a dividend (unless there is a credit balance in the resident company’s “tracking account” as discussed below) is:

\[
\frac{(\text{grey-list dividend} \times \text{tax rate})}{(1 - \text{tax rate})}
\]

Where:

“Grey-list dividend” (see below) is the amount of the dividend (including foreign withholding tax); and

“Tax rate” is the basic rate of income tax for companies for the income year the dividend is paid.

Example:

An Australian company pays a dividend of $28,000 (subject to zero Australian withholding tax deduction) to its New Zealand parent company on 1 February 2009.

The UFTC is $28,000 × 30/70 = $12,000.

The FDP liability on the dividend [see 670.130] is:

\[
\frac{((28,000 + 0 + 12,000) \times 0.30) - 0 - 12,000}{12,000 - 12,000} = \text{nil}
\]

(assuming the parent company does not have a credit balance in its tracking account).

The required conditions [s LL 3] to be met are as follows:

(a) The dividend must be derived from a grey-list company; and

(b) For all eligible accounting years, that company must have been liable to income tax (see below) in a grey-list country by reason of its domicile, residence, place of incorporation, or place of management; and

(c) For all eligible accounting years, that company must have calculated its income liable to income tax without applying any of the concessional features of tax law specified in sch 24, Part B (except for the Part B, para (1) exemption for offshore business activities, where that exemption applies for the company only because of business activities carried on in another grey-list country); and

(d) The grey-list company must be either:
   (i) At the time the dividend is paid, a member of the same wholly-owned group of companies as the resident company; or
   (ii) A foreign company at all times during the period ending with the dividend payment date, and commencing at the beginning of that company’s accounting year which is three years before the accounting year in which the resident company first had a required interest in that company (or the date of incorporation of that company, if later).

(e) The resident company must have maintained, and be able to furnish to the CIR on request, the “tracking account” that is necessary to determine to what extent a UFTC calculated as above applies to the dividend. The tracking account must have been maintained for transactions occurring on or after the “first tracking date”, which is the latest of:
   (i) 20 October 1992;
   (ii) The first day of the first eligible accounting year; or
   (iii) If the resident company so elects, the first day of any subsequent eligible accounting year (in which case the tracking account is credited with the grey-list country’s retained earnings at that date [see 670.260].
Income tax [s YA 2], for the purposes of the UFTC rules, broadly speaking means any taxes imposed by a taxing authority, whether of New Zealand or elsewhere, that are substantially of the same nature as New Zealand income tax or non-resident withholding tax, and includes any capital gains tax and branch repatriation or remittance tax.

If any of these conditions are not met, the UFTC for the dividend is instead calculated under s LL 3 [see 670.265].

(1) Adjustment for credit balance in tracking account

The tracking account is a memorandum account that operates from the first tracking date as an anti-avoidance device, to prevent dividends from non-grey-list companies, and other dividends that would not qualify for a deemed-tax paid UFTC, from being routed through grey-list companies to avoid FDP liabilities that would apply if those dividends were derived directly by a resident company. It records such dividends received by the grey-list company, and similar transactions with that company, as credits to the account.

The account is debited with all dividends paid by that company for which a UFTC as calculated above does not apply because of the existence of a tracking account credit balance (see below), determined as if the resident company had derived all such dividends. For this purpose, where because of the tracking account adjustment formula (see below) a dividend paid by the grey-list company does not qualify for full deemed-tax paid UFTC as per the formula above, the portion of the dividend that does not qualify is treated as a separate dividend for which a UFTC is separately available under s LL 3, based on actual tax paid by the grey-list company [see 670.265]. The tracking account is also debited with other applicable payments paid by the grey-list company to another grey-list company, if the resident company also maintains a tracking account for that other grey-list company.

Where the tracking account has a credit balance at the last day of the accounting year in which a dividend is paid by the grey-list company to the resident company, the portion of the dividend that does not qualify for a deemed-tax paid UFTC. The grey-list dividend (see above) is subject to limitations, and is defined in the following formula [s LL 3]:

\[
person's\ dividend \times \frac{\text{tracking account balance}}{\text{total grey-list dividends}}
\]

Where:

"Person’s dividend" is the amount of a foreign dividend before FDP is paid or any reduction for foreign tax.

The dividend shall be liable for the UFTC accounting period to income tax in a grey-list country and at least 80 per cent of the company’s income has a source from that country. A tracking account shall be maintained.

The grey-list company shall not have had income tax reduced by virtue of the exclusions in sch 24, Part B, (i). The grey-list company is either part of the same wholly-owned group when the dividend is paid, or has been a foreign company for the whole of the period ending on the day that the foreign dividend is paid,

“Tracking account balance” is the credit balance in the tracking account at the end of that year;

“Total grey-list dividends” is the total dividends paid by the grey-list company during that accounting year.

Example:

A resident company receives two dividends totalling NZ$8,000 from its 100 per cent-owned grey-list subsidiary during an accounting year. At the end of that year, the grey-list company has a credit balance in its tracking account of NZ$2,400. This balance is 30 per cent of the total dividends paid by the grey-list company during the accounting year. Accordingly, 70 per cent of each dividend will qualify for a deemed-tax paid UFTC to offset against FDP liability, with the remaining 30 per cent of each dividend being subject to the non-grey-list UFTC calculation [see 670.265].

A separate tracking account is required to be maintained for each such grey-list company.

670.260 Credits and debits to the tracking account [s LL 4]

(1) Credit of applicable payments

The tracking account is credited with certain amounts (termed “applicable payments”) derived or received by the grey-list company on or after the first tracking date and before the end of the accounting year in which
that company pays a dividend to the resident company. However, no credits arise where the applicable payments are paid to the grey-list company by any company resident in New Zealand, or where the applicable payments would have qualified for a s LL 3 deemed-tax paid UFTC had they been dividends derived by the resident company itself.

These applicable payments are:

(a) Any standard dividend for which the grey-list company is not liable for income tax. A standard dividend is any dividend derived by a shareholder in the form of money, release of shareholder from a loan, property distributed to a shareholder at an under-value, or a taxable bonus issue.

(b) Any dividend paid by a relevant associate for which the grey-list company is not liable for income tax (except where that dividend is either a standard dividend, which is caught under (a) above, or an attributed repatriation [see 850.80], or a dividend arising from the interest payable on a loan differing from the interest rate specified in s CD 39 if the loan itself is caught as an applicable payment [see item “(d)” below]).

A relevant associate is another company which, at the time of payment of the dividend, is associated with both the resident company and the grey-list company, and which is either a CFC or a resident company.

(c) Any amount contributed by a relevant associate to the grey-list company as new equity capital, to the extent the relevant associate has retained earnings at that time.

(d) Any loan by a relevant associate to the grey-list company, to the extent that the relevant associate has retained earnings at that time, except where the loan is both repayable and repaid within five years.

(e) Any non-dividend amount paid by a relevant associate for which the grey-list company is not liable for income tax, if that amount would be income if the grey-list company was a resident.

An amount derived by a grey-list country is treated as not being liable for income tax if the tax law of the relevant jurisdiction provides a rebate, credit, deduction, subsidy, or similar benefit that directly or indirectly rebates an income tax liability on that amount. However, this does not apply where the reduction in income tax liability is due merely to a current year loss offset, or to provisions equivalent to New Zealand’s rules for loss carry forward or grouping, credits for foreign tax or limitation of taxes under a double tax agreement, or BETA tax offsets [s LL 4].

(2) Credit of retained earnings

Where the resident company has elected [see 670.255] to maintain the tracking account from the start of a later eligible accounting year, the tracking account is also credited with the retained earnings of the grey-list company as at the day before that date.

Retained earnings is defined to mean the aggregate of a company’s shareholders’ funds (calculated under generally accepted accounting principles), after deduction of:

(a) Paid-up share capital;

(b) Any share premium account;

(c) Any amount subscribed by the company for shares in another company that has been credited to that other company’s tracking account;

(d) Any outstanding principal balance of a loan by the company that has been credited to another company’s tracking account; and

(e) Any other non-dividend amount paid by the company that has been credited to another company’s tracking account.

However, amounts of paid-up share capital or share premium account resulting from bonus issues or dividend reinvestment are not deducted from retained earnings, except to the extent that such amounts are:

(a) Foreign withholding payment dividends; or
(b) Derived subject to income tax by a shareholder of the company; or
(c) Applicable payments derived by another grey-list company for which the resident company also maintains a tracking account from the first tracking date prior to the date of the bonus issue or reinvested distribution.

(3) **Debits to tracking account**

The tracking account is debited with three types of payments made by the grey-list company after the effective date. These are:

(a) Amounts credited as above that is a dividend that would be a grey-list dividend under s LL 3 if derived by that person, a dividend paid by another company resident in New Zealand.

(b) An amount paid on or after the first tracking date and before the end of the relevant accounting year to another grey-list company, if the resident company also maintains a tracking account for that company from an first tracking date prior to the time each amount is paid, to which the amounts are credited.

(c) Amounts of dividends paid before the start of the relevant accounting year (i.e. the year in which the grey-list company pays the relevant dividend to the resident company) that do not qualify for a deemed-tax paid UFTC because of the existence of a credit balance in the tracking account (determined as if all such dividends were derived by the resident company).

**Example:**

If the resident company holds 60 per cent of the shares in the grey-list company and has received since the first tracking date dividends of $6,000 from that company for which a deemed-tax paid UFTC was not available, the debit to the tracking account would be $10,000 (not $6,000).

(4) **Foreign currency accounts**

Where the accounts of the grey-list company are not kept in New Zealand currency, the tracking account is also to be maintained in the foreign currency. Any applicable payment made in a different currency must, for this purpose, be converted to the tracking account’s currency at the close of trading spot rate on the date of payment.

(5) **Grey-list life insurers**

If the grey-list company is a life insurer, credits to the tracking account for applicable payments are limited to amounts that are actuarially determined to be attributable to shareholders’ profit or loss, rather than to policyholders. This does not apply, however, if the CIR considers that the amounts determined are not reasonable and fair, or if the CIR has not received on request sufficient information to review the actuarial calculations [s LL 4].

**670.265 Underlying foreign tax credit for dividends in other cases [s LL 2]**

An underlying foreign tax credit (UFTC) based on actual underlying foreign tax (i.e. tax paid on the earnings of the foreign company), will apply where:

(a) The dividend-paying foreign company is not a grey-list company; or

(b) The foreign company is a grey-list company but the s LL 3 conditions [see 670.255] have not all been met in respect of the dividend; or

(c) The tracking account maintained in respect of a grey-list company has a credit balance, so that a portion of the dividend is treated as a separate dividend that does not qualify for a s LL 3 deemed-tax paid UFTC.

The UFTC for such dividends is calculated for actual income tax [see 670.255] paid on the earnings of the foreign company for eligible accounting years, by allocating the proportion of tax paid on earnings to the dividend paid on a pro rata basis. The calculation includes credits for underlying foreign tax on dividends paid to the foreign company by lower tier companies in which the resident company also has a sufficient interest.
The amount of UFTC is calculated under the following formula [s LF 3(1)]:

\[(\text{non-grey-list dividend} / \text{earnings amount}) \times (\text{total tax paid} + \text{total UFTCs})\]

Where:

“Non-grey-list dividend” is the amount of the foreign dividend before deduction of any foreign withholding tax;

“Earnings amount” is the amount of the person’s foreign dividend company net earnings under s LL 5;

“Total tax paid” is the total amount of income tax or foreign income tax paid or payable by the foreign dividend company for the UFTC accounting period [see 670.270];

“Total UFTCs” is the total of foreign dividend company lower tier UFTCs under s LL 6 less the sum of:

(a) The total of credits that the person would have under this subpart in relation to all dividends paid by the foreign dividend company during its UFTC accounting period, excluding dividends paid during the current accounting year, and treating the dividends as derived by the person at a time when they have the required interest in the foreign dividend company; and

(b) The total amount of credits that the person would have under the formula in s LL 2(3) [see 670.255] if all dividends paid by the foreign company in its current accounting year are treated as derived by the person at a time when they have the required interest in the foreign dividend company.

If the foreign company’s financial statements are not prepared in New Zealand currency, the UFTC is to be calculated in the foreign currency and converted to New Zealand currency at the close of trading spot rate for the dividend payment date.

After-income tax earnings (or losses) means after-tax accounting profits (or losses), including extraordinary items, calculated under New Zealand generally accepted accounting principles and detailed in audited financial statements subject to requirements set out in s YA 1. In the absence of such financial statements, there are alternative requirements for the use of audited financial statements calculated under generally accepted accounting principles of the foreign country, or otherwise financial statements (which, if audited, must not be qualified) used by the foreign company for reporting to a central or state government or to creditors of the company. See also 670.275 for the position where no such statements exist, or where the statements do not fairly present the profits or losses of the company.

670.270 Underlying tax on dividends from lower tier companies [s LL 6]

In calculating the underlying foreign tax credit (UFTC) based on actual underlying foreign tax paid by a dividend-paying foreign company, under s LL 2, provision is made for taking into account underlying foreign tax on any dividend that has in turn been received by that company from another (ie “lower tier”) company, during any eligible accounting year. This applies only when the resident company has a required interest in both of the other companies at the time the dividend is paid, and where the dividend is a standard dividend [see 670.260].

Under s LL 6 A person has a foreign dividend company lower tier UFTC if:

(a) A company pays a standard dividend to a foreign dividend company during that company’s UFTC accounting period; and

(b) The person has the required interest in the company and in the foreign dividend company when the company pays the standard dividend.

The amount of the foreign dividend company lower tier UFTC is equal to the credit that the person would have under this subpart for the standard dividend, treating:

(a) A dividend other than a standard dividend as not existing; and

(b) A standard dividend as a foreign dividend received by the person.

This amount is limited to the lesser of

(a) The imputation credits attached to the standard dividend if the company is resident in New Zealand and is an imputation credit account (ICA) company; and
(b) An amount calculated using the formula:

\[
((\text{relevant standard dividend} + \text{lower tier UFTC} + \text{tax withheld}) \times \text{company rate}) - \text{tax withheld}
\]

Where:

“Relevant standard dividend” is the amount of the standard dividend after the subtraction of tax withheld in relation to the dividend;

“Lower tier UFTC” is the amount of the foreign dividend company lower tier UFTC under subsection (2) for the standard dividend

“Tax withheld” means the tax withheld and paid in relation to the standard dividend

“Company rate” is the basic rate of income tax set out in sch 1, Part A, cl 2 for the tax year in which the standard dividend is paid.

If the lower tier company is a grey-list company, the amount of UFTC determined in relation to the lower tier company’s dividend could be a s LL 3 deemed-tax paid UFTC [see 670.255]. However, for this to be the case the resident company would have needed to have maintained a tracking account for the lower tier company.

It is possible for a lower tier company to be resident in New Zealand. If so, the amount of UFTC calculated for a dividend that it pays is further limited to the amount of any imputation credit attached to the dividend (unless it has never been required to maintain an ICA (eg where it is treated as non-resident under a double tax agreement) [see 670.20, s LF 6].

This effectively limits the maximum UFTC amount to the amount of New Zealand tax that would be payable on that dividend.

**670.275 Underlying foreign tax credit information requirements and procedures [TAA, s 78F]**

(1) **Claiming of underlying foreign tax credit against FDP liability**

Where the resident company reduces its “foreign dividend payment” (FDP) liability on a foreign dividend by an amount of “underlying foreign tax credit” (UFTC) under s LL 2, no such reduction is allowed unless the taxpayer supplies the CIR with all information specified by the CIR as being necessary to verify the UFTC calculation, including any tracking account details if requested, within such period as the CIR may allow [TAA, s 78F]. This is similar to the FDP requirements for evidence of foreign withholding tax paid on a dividend [see 670.130].

In practice, the taxpayer claims the UFTC reduction in the Foreign dividend payment (FFDP) Return (IR4F), and may subsequently file a FFDP Reconciliation (IR4FR) if FDP is initially paid on the basis of an estimated UFTC amount. See 670.210 regarding two-way use of money interest and penalties on FDP payments.

(2) **Evidence of foreign tax paid**

For the purpose of a UFTC calculated under s LL 2, the foreign company (or any lower tier company) is treated as having no amount of income tax payable on its earnings for an accounting year unless the resident company taxpayer can supply (if requested) to the CIR [TAA, s 78F]:

(a) A copy of a relevant revenue authority receipt evidencing the tax paid;

(b) A copy of the foreign company’s filed income tax return showing the tax payable;

(c) A copy of a statement of account from the relevant revenue authority requesting payment of that amount; or

(d) Other evidence, such as an auditor’s certificate, that satisfies the CIR.

(3) **Misreporting of foreign company earnings**

Where a company calculates a UFTC credit under s LL 2 and no satisfactory financial statements exist for that company, it may be deemed to have paid no income tax in certain eligible accounting years [TAA, s 78F].
This applies where:

(a) The taxpayer has reason to believe that the statements used to measure the after-income tax earnings (or loss) of the company for an eligible accounting year do not fairly represent actual profit or loss;

(b) The CIR has concluded to the same effect; or

(c) No statements of the company exist which meet the requirements set out in the definition of after-income tax earnings [see 670.265].

In each case, for s LL 2 UFTC calculation purposes, that company is deemed to have paid no income tax either for that accounting year or for the immediately preceding and succeeding accounting years.

**670.280 Interest paid in conduit financing arrangements [s LL 7]**

An anti-avoidance rule in s LL 7 places a limitation on the deductibility of interest that is paid offshore by a company, where the company (or an associate) derives a dividend from a grey-list company for which a s LL 3 deemed-tax paid underlying foreign tax credit (UFTC) arises. It is directed at curtailing the opportunity that would otherwise exist for foreign investors to create a New Zealand tax loss position for a company, by using that company as an offshore debt-financed conduit for equity investment into a grey-list country, whereby the company would derive dividends not subject to foreign dividend payment (FDP).

The limitation on deductibility arises for interest expenditure of a company for an income year if the following applies:

(a) In that year, or a prior year, a dividend for which an amount of s LL 3 deemed-tax paid UFTC has arisen is derived by the company, or by a resident company that is associated with the company at the time of derivation; and

(b) The interest is paid by the company to the foreign dividend-paying company, or to a foreign company that is associated at the time of payment with the foreign dividend-paying company (whether paid directly or indirectly or by a series of transactions); and

(c) The foreign company that receives the interest is not a controlled foreign company (CFC) at the time; and

(d) Non-resident persons have voting interests (or, if a market value circumstance exists, market value interests) aggregating 50 per cent or more in the foreign dividend-paying company (and, if it is an associated company that receives the interest, in the associate), at either the time of payment of the interest or the time of payment of the dividend.

In this situation, deductibility for such interest expenditure for the company for that income year is effectively limited to the amount by which that interest expenditure, together with any amounts of such interest expenditure similarly disallowed as a deduction under s DX 2 in any prior income year, exceeds the aggregate of the amounts of dividends derived by the company (or by its resident associate), in the current or prior income years, for which amounts of s LL 3 deemed-tax paid UFTC have arisen. In other words, the interest expenditure is non-deductible over the loan period to the extent of the grey-list company dividends.

**670.285 Branch equivalent tax account rules**

**(1) Repeal of FDP**

Following the exemption for most foreign dividends received by companies in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009, from income years beginning on or after 1 July 2009, the foreign dividend payment (FDP) rules have been repealed.

Consequently branch equivalent tax accounts (BETA) for companies will be phased out. As income tax will continue to apply to foreign dividends received by non-companies, BETA accounts have been retained for Individuals.

**Note:** Inland Revenue advise in their special report on the international tax rules that companies with BETA debit balances will be able to continue to use these debits to relieve any double taxation on attributed income for a two-year period. Any remaining BETA debits will then be extinguished. The legislation to achieve this
Imputation

is contained in the Taxation (International Investment and Remedial Matters) Bill highlighted in Future Tax Developments.

Sections OE 12 to OE 16 and OP 105 to OP 108 have been repealed to prevent branch equivalent tax accounts (BETA) debit balances from increasing under the new rules.

Sections OE 16B and OP 108B provide a BETA debit to extinguish any existing BETA credit balances as BETA credits are no longer required to relieve FDP once FDP has been repealed.

Note: A new provision, s OE 11B (that applies for income years beginning on or after 1 July 2009), has been inserted to ensure that a BETA debit that arose in respect of FDP that was offset by conduit tax relief under s RG 7 is only available to be offset against pre-reform CFC income [see 670.305].

(2) Previous rules

Under the international tax rules, a resident taxpayer is taxed on attributed foreign income from an income interest (10 per cent or more) held in a controlled foreign company (CFC), and on foreign investment fund (FIF) income [see 850 INTERNATIONAL TAX REGIME]. The branch equivalent tax rules exist to prevent double taxation arising when the resident receives a dividend that is sourced from such foreign income.

The regime permits any resident taxpayer to maintain a branch equivalent tax account (BETA). The BETA is a memorandum account that is designed to record the taxpayer’s payments of income tax on attributed foreign income (including certain FIF income), and the offset of credits for those payments against the resident’s tax liability for dividends received from the CFC or FIF investment. If a resident company maintains a BETA, such BETA credits are offset against the company’s FDP liability on dividends received [see 670.130]. For a resident BETA person [see 670.340], BETA credits are offset against the person’s income tax liability on such dividends.

The BETA rules for companies permits the (converse) offset of FDP paid on dividends received against a company’s income tax liability on attributed foreign income. This prevents double taxation arising when a dividend was received before the company paid income tax on its attributed foreign income from a CFC. Payments of FDP are recorded as debits to the BETA (as well as credits to the FDPA), and can be applied to reduce the income tax liability on attributed foreign income [see 670.315].

The BETA rules are principally contained in subpart OE, and differ between companies and persons, as set out below.

670.285(2)

Election by company to maintain a BETA [ss OA 2, OE 1]

Any resident company can elect to maintain a branch equivalent tax account (BETA) for a tax year (eg by way of directors’ resolution to do so). The election must be made either within that 31 March year, or else within the period allowed for the company’s income tax return for the corresponding income year to be filed. The CIR has discretion to accept a later election. Written notice of the election must be given to the CIR within 21 days, or within such further time as the CIR may allow.

Note: Failure to notify the CIR does not make the election void, although it is an offence [see 1110.225, 1110.230]. See also 670.320 for the amended imputation credit account (ICA) return required if the company has filed its ICA return before it makes a BETA election.

A company that elects to maintain a BETA must do so for the tax year that is the subject of the election, and for every subsequent tax year until it ceases to be a BETA company (eg on liquidation). The company can, in a subsequent tax year, elect to cease to be a BETA company, with effect from the start of the next succeeding tax year. Accordingly, when a company elects to maintain a BETA, it must do so for at least two full tax years. An election to cease to maintain a BETA has no effect unless the company files its annual imputation return for the year of the election within the time allowed for filing its annual income tax return.

670.285 Information to be recorded in a company’s BETA [s OA 3]

The branch equivalent tax account (BETA) of a company must record for each tax year the 1 April opening balance for the year and credits and debits to the account as they arise. The rules in this regard, including the
powers of the CIR to correct any entry or omission [s OA 1; TAA, s 104B], are essentially the same as for the imputation credit account [see 670.25]. See also 670.80 for record keeping requirements.

670.300 Credits to the BETA of a company [ss OE 6, OE 7, OE 8, OE 9, OE 10, OE 11]

A BETA company has a branch equivalent tax credit [s OE 6] for an amount calculated using the formula:

\[ (((\text{CFC income for year} - \text{deductions for year}) \times \text{tax rate}) - \text{foreign tax credits} - \text{debit balances}) \]

Where:
- “CFC income for year” is the amount of attributed CFC income derived during the income year corresponding to the tax year referred to in s OE 6(3);
- “Deductions for year” is the total amount in the income year corresponding to the tax year of attributed CFC loss, and attributed CFC net loss, and FIF loss, and FIF net loss;
- “Tax rate” is the basic rate of income tax set out in sch 1, Part A, cl 2 if the company is not a Maori authority; or sch 1, Part A, cl 7 if the company is a Maori authority;
- “Foreign tax credits” is the amount of foreign tax credits allowed for the income year corresponding to the tax year referred to in s OE 6(3) under ss LK 1 to LK 7 (which relate to foreign tax credits of CFCs), as applicable.
- “Debit balances” is the total amount of all debit balances in a BETA applied to satisfy the company’s income tax liability for the income year corresponding to the tax year referred to in s OE 6(3).

The credit arises on the day the company files the return of income for the tax year.

A credit arises [s OE 7] when there is a debit balance in the BETA; and the income of the company includes an amount of attributed CFC income; and an amount of FDP that gives rise to a debit included in the debit balance has been paid directly, or by reducing a tax loss, or to reduce an FDP liability under s RG 7 for conduit tax relief.

Section OE 7 also applies in relation to a BETA company if another company (company B) that is part of the same group of companies has a debit balance in its BETA that arises in the above circumstances. The company or company B may choose to apply some or all of the debit balance according to s BC 8 to satisfy an income tax liability in relation to the attributed CFC income. The election is made by recording a credit in the BETA with the debit balance. The maximum amount that may be applied to satisfy the income tax liability must be no more than the amount that has the attributed CFC income [under s OE 6(1)] and treating the item debit balances as zero. The amount that is applied to satisfy the income tax liability is a credit in the BETA of the company that made the election.

If the amount that is applied to satisfy the income tax liability for attributed CFC income is more than the total income tax liability, then the unused portion is treated as a tax loss component of the company of an amount calculated using the formula:

\[ \frac{\text{unused portion}}{\text{tax rate}} \]

Where “tax rate” is the basic rate of income tax set out in sch 1, Part A, cl 2 if the company is not a Maori authority; or sch 1, Part A, cl 7 if the company is a Maori authority.

The income tax liability is calculated by applying the formula in s OE 6(1) on the basis that the item debit balances is zero; and is satisfied to the extent to which the liability is no more than the income tax payable in relation to the amount of the attributed CFC income. The credit arises on the day of the election.

A credit arises [s OE 8] when an income tax liability of a BETA company is satisfied by applying a debit balance in the company’s BETA, or in the account of another company in the same group of companies, and an unused portion of the debit balance remains after the income tax liability is satisfied. The unused amount is converted into a tax loss component and is calculated using the formula:

\[ \frac{\text{ unused amount}}{\text{tax rate}} \]

Where
- “Unused amount” is the amount of the debit balance remaining in the BETA;
“Tax rate” is the basic rate of income tax set out in sch 1, Part A, cl 2 if the company is not a Maori authority; or sch 1, Part A, cl 7 if the company is a Maori authority.

The company that has the tax loss is the company whose income tax liability is satisfied as set out in s OE 7(3).

A credit arises [s OE 9] for the amount of a refund of FDP paid to the company. However, the following provisions also apply: A refund must be a refund of a payment of FDP that gave rise to a debit under s OE 12. The amount of the credit is to be reduced to the extent to which the payment of FDP is made before a branch equivalent tax credit arises under s OE 10 in the company’s BETA; and the amount of the refund is no more than the amount of the credit for loss of shareholder continuity. The credit arises on the day the refund is made.

A credit arises [s OE 10] for the amount of a branch equivalent tax debit retained in the BETA and unused before the date on which shareholder continuity is lost. The credit arises on the day of loss of shareholder continuity.

A credit arises [s OE 11] for a debit balance in the BETA when the company stops being resident in New Zealand on the day when the company stops being a New Zealand resident.

670.305 Debits to the BETA of a company [ss OE 12, OE 13, OE 14, OE 15, OE 16]

A BETA company has a branch equivalent tax credit [s OE 12] for the amount of a payment of FDP that is calculated before a reduction of liability under s RG 7 for reduction of payments for conduit tax relief. It must have been payable in relation to a dividend derived from an income interest in a CFC; and may have been paid by choosing to reduce a tax loss. The debit arises on the day of payment.

A debit arises [s OE 13] when a BETA company may choose to use some or all of a credit balance in the BETA to reduce an FDP liability of the company or of another company that is part of the same group of companies when the dividend giving rise to the liability is derived. The amount of the reduction is a debit arising in the company’s BETA. The company makes the election by recording the amount of the credit balance that is used as a debit in the account. The debit date arises on the due date for the payment of FDP.

A debit arises [s OE 14] when a BETA company has a branch equivalent tax debit for the amount of a refund of income tax that is attributable to income tax paid for an income year on attributed CFC income derived during the income year. This is subject to the following provisions. The amount of the debit is reduced to the extent to which a debit arises in the company’s BETA under s OE 15; and the income tax was paid before the debit date for the debit for loss of shareholder continuity. The debit arises on the date the refund is made.

A debit arises [s OE 15] when there is a branch equivalent tax debit for the amount of a branch equivalent tax credit retained in the BETA and unused before the date on which shareholder continuity is lost. The debit arises on the day of loss of shareholder continuity. Section GB 40 may operate to exclude the application of this section [see 670.325].

A debit arises [s OE 16] when there is a branch equivalent tax debit for a credit balance in the BETA when the company stops being resident in New Zealand. The debit arises on the day the company stops being resident in New Zealand.

670.310 Use of BETA credit balance to reduce company FDP liability [s OE 13]

A branch equivalent tax account (BETA) company can elect to utilise part or all of any credit balance in its BETA to reduce its foreign dividend payment (FDP) liability, or the FDP liability of another company that is in the same group of companies at the time that the relevant dividend is paid [s OE 13]. For this to apply, the FDP liability must arise from a dividend paid by a CFC, in respect of an income interest (of 10 per cent or more) held by the recipient company [s RG 5].

To the extent that the BETA credit balance has arisen from income tax payable on attributed foreign income, under s OE 2(2), the FDP offset is permitted only in so far as the company has paid that amount of income
use of BETA debit balance to reduce company income tax liability [s OE 7]

A company can elect to utilise part or all of a debit balance in its branch equivalent tax account (BETA) to reduce its income tax liability, or that of another company that is in the same group of companies for the relevant income year, for attributed foreign income derived from a controlled foreign company (CFC). This offset prevents double taxation arising when a CFC paid a dividend (subject to FDP) before the recipient company paid income tax on its attributed foreign income from the CFC.

The BETA company’s election is made by recording a credit for the amount in its BETA.

The set off against the company’s income tax liability is available only to the extent that the CIR is satisfied that the company has paid the FDP (including by loss offset) [see 670.135] that gives rise to the BETA debit balance [s OE 7], or (in the case of a conduit tax relief company) has received a reduction in the FDP liability under s RG 7 [see 670.130].

If an election relates to an amount that exceeds the income tax liability of the company for the income year, the excess is a net loss of the company. The amount of the loss is calculated as the amount of the excess divided by the tax rate of the entity concerned.

670.320 Annual and other returns for BETA company [TAA, ss 69, 70, 77]

Requirements for a company to provide to the CIR details for a tax year of its branch equivalent tax account (BETA) (opening and closing balances, and the amount and source of all credits and debits) are set out in ss 69 and 70 of the TAA, on the basis that those details are to be supplied as part of the company’s annual (or other) imputation credit account (ICA) return [see 670.65]. A separate BETA return form (IR4X) is used as the BETA company return, and it must be filed with the company’s ICA return.

For the tax year of the company’s election to maintain a BETA, the company’s annual ICA return may have been filed before the election is made [see 670.290] and so may not contain the required BETA details. If so, then s 77 of the TAA stipulates that an amended ICA return for that year containing those details must be filed immediately after the election is made (ie in practice the BETA return form for that year must then be immediately filed).

670.325 Shareholder continuity requirements for BETA company [s OE 15]

For a company to continue to carry debits or credits in its branch equivalent tax account (BETA), it must satisfy the 66 per cent shareholder continuity provisions contained in s OE 15. If it does not do so, then at the time of the breach of the required shareholder continuity:

(a) A credit arises to the BETA that extinguishes those debits in the BETA at that time (eg for foreign dividend payment (FDP) paid that have not been cancelled out before that time by a subsequent credit (accordingly, any BETA debit balance is effectively lost) [see s OE 10 and 670.300]; or

(b) A debit arises to the BETA that extinguishes those credits in the BETA at that time (eg for income tax paid on attributed foreign income) that have not been cancelled out before that time by a subsequent debit (accordingly, any BETA credit balance is effectively lost) [see 670.305].

The BETA 66 per cent shareholder continuity requirements are identical to the imputation credit account (ICA) shareholder continuity requirements [see 670.75]. This includes the requirement for any uncancelled
pre-1 April 1992 credits to the BETA to satisfy both the pre-1 April 1992 continuity requirements (as if the then required continuity percentage was 66 per cent and not 75 per cent), and the current post-1 April 1992 continuity requirements.

**670.330 Branch equivalent tax account year end debit balance consequences for a BETA company**

The branch equivalent tax account (BETA) operates as a debit account (for foreign dividend payment (FDP) paid) as well as a credit account (in respect of income tax paid on attributed foreign income). Accordingly, unlike the rules applying to an imputation credit account (ICA) or foreign dividend payment account (FDPA), no further amount of tax or penalties become payable if the BETA has a debit balance at 31 March year end.

**670.335 Anti-avoidance provisions for a BETA company** [s GB 40]

Branch equivalent tax account (BETA) shareholder continuity anti-avoidance rules are contained in s GB 40, which parallel those applying in s GB 34 [see 670.75] for imputation credit account shareholder continuity.

**670.340 Branch equivalent tax account person** [ss OE 17, YA 1]

A branch equivalent tax account (BETA) person is a resident person other than a company who maintains a BETA pursuant to an election made under s OE 17 [see 670.345]. Such a person [s YA 1] may be an individual, or an unincorporated body of persons, or any entity that is not a company for BETA purposes.

For a BETA person, the only BETA credit entry that arises is for income tax paid on attributed foreign income from a 10 per cent or greater income interest in a controlled foreign company (CFC) (or on foreign investment fund (FIF) income calculated according to the branch equivalent method or the accounting profits method, or from certain other FIF interests [see 670.370].

Whereas a BETA company utilises a BETA credit balance to reduce its FDP liability on dividends received from a 10 per cent or greater income interest in a CFC (or from certain FIF interests, as above), a BETA person utilises a BETA credit balance to reduce the income tax liability on similar dividends.

A BETA person maintains the BETA on an income year (ie accounting year) basis, unlike a BETA company [see 670.345].

**670.345 Election by person to maintain a BETA** [s OE 17]

Any resident person (not being a company) can elect to maintain a branch equivalent tax account (BETA) for an income year (ie the person’s accounting year). The election must be made either during that income year, or else within the period allowed for that person to file the income tax return for that year. The CIR has discretion to accept a later election. Written notice of the election must be given to the CIR within 21 days, or within such further time as the CIR may allow.

A person who elects to maintain a BETA must effectively do so for at least two full income years [ss OE 17 to OE 18]. An election to cease to maintain a BETA has no effect unless the person furnishes the annual BETA return [see 670.365] for the year of the election, within the period allowed for filing the corresponding annual income tax return.

The BETA of a person must record, for each income year, the opening balance (carried forward from the previous year) and debits and credits as they arise [ss OA 5, OA 6].

**670.350 Credits and debits to the BETA of a person** [ss OA 5, OA 6, OE 19, OE 20, OE 21, OE 22]

Credits to the branch equivalent tax account (BETA) of a person arise solely for income tax payable for attributed foreign income derived by the person, calculated as follows:

\[
\text{tax liability} \times \left( \frac{\text{CFC or taxable income}}{\text{taxable income}} \right) - \text{foreign tax credits}
\]

Where:

"Tax liability" is the person’s income tax liability [s BC 6] for an income year;
“CFC or taxable income” is the lesser of the person’s attributed CFC income or taxable income for that income year;
“Taxable income” is the person’s taxable income for that income year; and
“Foreign tax credits” is the amount of any foreign tax credit allowed under ss LK 1 to LK 7 [see 850.95 to 850.110] for that income year (ie for attributed foreign income).
The credit to the BETA arises on the date the person files the income tax return for that year [s OE 19].
Debits to the BETA of a person for an income year arise from:
(a) Any amount of the BETA credit balance that the person elects to credit against the income tax liability on a dividend derived from a 10 per cent or greater income interest in a controlled foreign company (CFC). The debit arises on the date the person makes the election, by recording the debit in the BETA;
(b) The portion of any income tax refund that comprises a refund of income tax paid on attributed CFC income. The debit arises on the date the refund is paid; and
(c) The amount of the BETA credit balance where the person ceases to be resident. The debit arises on the date the person ceases to be resident [ss OE 20 to OE 22].

670.355 Offset by BETA person against tax on controlled foreign company dividend [s OE 20]
When a branch equivalent tax account (BETA) person’s income includes a dividend from a 10 per cent or greater income interest in a controlled foreign company (CFC), the person can elect to utilise part or all of a credit balance in the BETA at the time of election as an offset against the income tax liability on the dividend [s OE 20]. The election is made by recording a debit for the amount in the BETA.
The credit against the person’s income tax liability is allowed only to the extent that the person has paid income tax (including provisional tax) at least equal to the amount of BETA credit balance utilised, for the income year in which the corresponding BETA credits arose.

670.360 Branch equivalent tax account debit balance consequences for a BETA person
It is possible that a BETA debit balance could arise for a BETA person. However, no liabilities for payments of further tax or penalties arise if this situation does occur.

670.365 Annual and other returns for a BETA person [TAA, s 78]
A branch equivalent tax account (BETA) person must file an annual return in the prescribed form (IR3X) for each income year, within the period allowed for filing the income tax return for that year. The BETA return must show the opening and closing balances and the amount and source of all credits and debits for the BETA for that year, and such other information as the CIR may prescribe.
Other circumstances in which a BETA return is to be furnished are:
(a) As and when required by the CIR for any specified period; and
(b) If the person ceases to be resident, in which case the BETA return must be filed no later than the date of cessation of residency.

670.370 Extension of BETA regime to certain foreign investment fund interests [s OE 5]
Both resident companies and resident persons can also elect to maintain a branch equivalent tax account (BETA) in respect of certain foreign investment fund (FIF) interests [s OE 5]. This applies to:
(a) Any FIF interest held where the taxpayer’s FIF income is calculated under the accounting profits method [see 850.165] or the branch equivalent method [see 850.170];
(b) A FIF interest held through a controlled foreign company (CFC), in which case ss EX 50(6) or EX 58 applies to attribute FIF income or loss (calculated under any calculation method) to the resident company or person [see 850.50];

(c) A FIF interest held through another (ie higher tier) FIF, where the branch equivalent method has been used by the resident taxpayer to calculate FIF income or loss for the higher tier FIF, in which case s EX 50 similarly applies to attribute FIF income or loss (calculated under any calculation method) from the lower tier FIF to the resident company or person.

The BETA provisions contained in subpart OE apply in such circumstances as if the resident taxpayer’s FIF income was attributed foreign income from a CFC in which the taxpayer had a (10 per cent or greater) income interest.

In such circumstances, s RG 5 [see 670.130] also applies, so that a FDP liability can arise for a company on dividends received from the FIF interest. This should generally only be relevant in (a) above (ie where the FIF interest is directly held by the company).

670.375 Trans-Tasman imputation — overview

The imputation systems of New Zealand and Australia have been reformed to eliminate the problem of “triangular tax”. The problem arises because both New Zealand and Australia allow only tax paid in their own country to generate imputation or franking credits, and only resident companies to pass imputation or Australian franking credits to their shareholders. This resulted in New Zealand investors in an Australian company that carried on business in New Zealand being unable to claim an imputation credit for New Zealand tax paid by the company. The same applied to Australian investors in a New Zealand company that carried on business in Australia.

Under the trans-Tasman imputation regime, where a New Zealand company chooses to register under the Australian system, it is permitted to maintain an Australian franking credit account to record tax paid in Australia in addition to its New Zealand imputation credit account in which it will record tax paid in New Zealand. The same applies to an Australian company which chooses to register under the New Zealand imputation system. In both cases, imputation and franking credits are required to be allocated proportionately across all shareholders. Only New Zealand residents are able to claim a credit for imputation credits and only Australian residents are able to claim a credit for franking credits.

Australian companies are eligible to maintain a New Zealand imputation credit account from 1 April 2003 and pay dividends with New Zealand imputation credits attached from 1 October 2003.

Example:

An Australian company carries on business in both Australia and New Zealand. The company is owned as to 50 per cent by New Zealand shareholders and 50 per cent by Australian shareholders. The company’s Australian income is $2,500 with tax payable in Australia of $750. The company’s New Zealand income is $1,500 with tax payable in New Zealand of $450. The company pays a dividend of $1,400 cash.

From 21 July 2005, imputation credits are unable to be allocated to dividends that constitute interest under Australian tax law. This includes dividends paid on redeemable preference shares. Where these rules prevent imputation credits from being attached, the dividend may be ignored for the purposes of the benchmark dividend rules.

Grand parenting rules provide that the restriction does not apply to shares issued before 21 July 2005 where the shareholder is not a member of the same group of companies as the dividend-paying company or where the two companies are in the same wholly-owned group of companies but neither is resident in New Zealand [s OB 63]. There is a further exemption in s OB 63) for shares issued before 21 July 2005 where the two companies are in the same group of companies and the shareholder acquired the share under any one or more of the following circumstances:

(a) As part of a share-broking business;
(b) As an investment as part of an insurance business;
(c) As security for a loan given as part of a money-lending business;
(d) As a trustee for a beneficiary who is not a company in the same group of companies as the shareholder; or
(e) For other reasons which do not include the fact that the two companies were members of the same group of companies.
Prior to the reforms, the company could attach to the dividend only the franking credits arising from the tax paid in Australia. These credits could be used only by the company’s Australian shareholders. This resulted in the Australian shareholder receiving a fully-franked dividend of $700 and the New Zealand shareholder receiving a dividend of $700 with no credits attached.

Following the reforms, each shareholder would receive a $700 dividend with $300 franking credits and $225 imputation credits attached. The Australian shareholder would be able to claim the $300 franking credits (but not the imputation credits) and the New Zealand shareholder would be able to claim the $225 imputation credits (but not the franking credits).

670.380 Imputation groups

The concept of imputation groups has been introduced to alleviate the problem of imputation credits not being able to be passed through intermediate companies that are resident in countries other than Australia and New Zealand.

The concept of imputation groups allows any company that is resident in either New Zealand or Australia to pay an imputed dividend provided that any company within the group has paid tax in New Zealand or received imputed dividends from a company outside of the group.

There is no requirement to pay dividends up the chain of companies, thereby removing the necessity to pay a dividend up through a company not resident in New Zealand. Instead, imputation credits held further down the chain of companies can be accessed by the parent company.

670.385 Eligibility for membership of an imputation group [s FN 4]

Only companies resident in either Australia or New Zealand are eligible to be included in an imputation group. The criteria that must be satisfied differ depending on whether or not the company is a member of a consolidated group.

Where a company is not a member of a consolidated group, it is eligible to be a member of an imputation group where:

(a) Each member of the imputation group is a company that is:
   (i) Resident in either Australia or New Zealand, and is not treated by a double tax agreement as resident in neither Australia nor New Zealand;
   (ii) Either required under s OB 1, or has elected under s OB 2 to do so; and
   (iii) Is not a loss attributing qualifying company; and
(b) The members of the imputation group are a wholly-owned group of companies;
(c) Either no member of the imputation group is a qualifying company or all members of the imputation group are qualifying companies;
(d) Either no member of the imputation group is a mining company or all members of the imputation group are mining companies; and
(e) No shares in any company that is a member of the imputation group have been subject to an arrangement or series of arrangements, or had rights attaching to them extinguished or altered, in such a way as to enable the company to be a member of the imputation group.

A company that is a member of a consolidated group of companies is eligible to be a member of an imputation group if, at that time:

(a) All of the above requirements are or would be satisfied;
(b) All members of the consolidated group are or would be members of the imputation group; and
(c) If the imputation group contains or will contain members of more than one consolidated group, all of those consolidated groups have been part of a single wholly-owned group of companies at all times from the date on which a currently uncancelled imputation credit arose in the imputation credit account of a consolidated group or imputation group all of whose members are, or would be, members of the imputation group.
670.390 Forming, joining and combining imputation groups [ss FN 3, FN 4, FN 5, FN 6, FN 7, FN 8, FN 9]

In order to form or join an imputation group or to combine groups, it is necessary to make an election in a form acceptable to the CIR. The following elections may be made:

(a) An election by any two or more companies that are not members of a consolidated group to form an imputation group.

(b) An election by a company that is not a member of a consolidated group to become a member of an existing imputation group.

(c) An election by all members of consolidated group to form an imputation group with companies that are not members of that consolidated group. The election is made by the nominated company of the consolidated group.

(d) An election by all members of consolidated group to join an existing imputation group provided that all companies that are to be members of the proposed imputation group are at that time eligible to be members.

With the exception of (b) above, any election must nominate one of the companies to be agent of the group for the purposes of the imputation rules [see 670.395]. Any election has effect from the beginning of the tax year that contains the date on which the CIR receives the notice of election.

All companies that are members of an imputation group are jointly and severally liable for further income tax, civil penalties and interest arising from the operation of the imputation credit account of the imputation group. An imputation group cannot be formed with only one member. However, if the membership of the group falls to one, the group is able to continue in existence.

Where an imputation group includes one or more Australian companies, a resident imputation subgroup must be formed. The members of this subgroup are the New Zealand resident members of the trans-Tasman group. A resident imputation subgroup can be formed, and continue to exist, with only one member. However, if at any time the subgroup has no members, it ceases to exist.

670.395 Nominated company of an imputation group [s FN 6]

The nominated company for an imputation group must be a member of the imputation group. That company is the agent of the imputation group and of each company that is, at that time, a member of the imputation group.

The nominated company of a trans-Tasman imputation group, which must not be an Australian imputation credit account company, is also the nominated company for the resident imputation subgroup that is associated with the trans-Tasman imputation group.

Where the nominated company wishes to cease to act in that role, it may give the CIR notice that it is to cease to be the nominated company and that another company in the imputation group take over that role. The notice becomes effective 30 days after the date on which the CIR receives the notice.

670.400 Leaving an imputation group [ss FN 11, FN 12, FN 13, FN 14]

A company ceases to be a member of an imputation group if:

(a) The company elects in writing that it cease to be a member;

(b) The company ceases to be eligible to be a member;

(c) The company ceases to be a member of the same imputation group as the nominated company of that group; or

(d) The imputation group of which that company is a member ceases to have a nominated company.

Where the company has elected to cease to be a member, the election takes effect from the date (if any), specified in the notice of election. If no date has been specified, the election takes effect from the later of the beginning of the tax year in which the CIR receives the notice, or the time at which the company became a member of the imputation group.
Where a company ceases to be eligible to be a member of an imputation group, or ceases to be an eligible member of the same imputation group as the nominated company, the company may elect that cessation take effect from the date on which eligibility ceases. Any such election must:

(a) Be made in writing in an acceptable form; and

(b) Be received by the CIR within 30 days after the date on which the company ceases to be eligible to be a member of the group, or ceases to be eligible to be a member of the same group as the nominated company, or within such further time as the CIR may allow.

In order for the election to be effective, the CIR must not reasonably be able to conclude that an arrangement has been entered into to defeat the intent and application of the imputation rules. Where no such election is made, cessation takes effect from the later of the beginning of the tax year in which eligibility ceases or the date on which the company became a member of the imputation group.

A company that is not the nominated company and which ceases to be eligible to be a member of the same imputation group as the nominated company may make an election that cessation takes effect from the date on which eligibility ceased. Where no such election is made, cessation takes effect from the later of the beginning of the tax year in which eligibility ceases or the date on which the company became a member of the imputation group. The same election criteria apply as set out above.

Where an imputation group ceases to have a nominated company and no replacement is appointed, the companies in the group cease to be members of the group with effect from the beginning of the tax year.

If the nominated company is liquidated, the other companies in the group may elect another company in the group to fill that role from the date of liquidation. The is achieved by notifying the CIR within 30 days or such longer time as the CIR may allow.

In all cases, where a company ceases to be a member of an imputation group by virtue only of it being liquidated, the deemed date of cessation is not backdated to the beginning of the tax year.

**670.405 Australian resident imputation credit account companies**

Under the trans-Tasman imputation system, an Australian resident company is able to elect to maintain an imputation credit account (but not a foreign dividend payment account), and is able to distribute dividends with both imputation credits and Australian franking credits attached.

**Eligibility**

In order to be eligible, the Australian company must be excluded from the requirement to maintain an imputation credit account and be:

(a) Resident in Australia; and

(b) Not be treated under a double tax agreement as being resident in a country that is neither Australia nor New Zealand.

The term “resident in Australia” is defined in s YA 1 as meaning a company which is not resident in New Zealand but which would be resident in New Zealand under ss YD 2 and YD 3 if Australia was treated as being New Zealand under that provision.

**Election**

The election is made using form IR488. The CIR is able to decline an election for an Australian company to become an imputation credit account company if an election by that company has previously been revoked by the CIR, and the company does not satisfy the CIR that the company has taken adequate steps to prevent the recurrence of the type of situation that gave rise to that revocation.

A notice that accepted by the CIR comes is effective from the beginning of the tax year in which the election is received by the CIR for all purposes other than the attaching of imputation credits to dividends.

For the purposes of attaching imputation credits to dividends, the election is effective from:
(a) The beginning of the tax year in which the CIR receives the election if the company is formed, or
becomes eligible, in the tax year where the CIR confirms the election as being effective from the
beginning of the tax year; or
(b) In all other cases, 30 days following the receipt by the CIR of the election.

Once the company has made an effective election, it must establish and maintain an imputation credit account
until:

(a) For the purposes of attaching imputation credits, until the date on which it ceases to be eligible to be
an imputation credit account company or the date on which the election is revoked either by the
company or by the CIR; and
(b) For all other purposes until the end of the tax year of revocation or cessation of eligibility.

Any company that is in the same wholly owned group of companies with the electing company is jointly and
severally liable with the electing company for all further income tax, civil penalties and interest that arises
from a breach by the electing company of the imputation rules. The joint and several liability is subject to it
not being prohibited by an independent regulatory body.

Any election may be revoked by the company by way of notice in writing. Any such notice is effective from:

(a) The date on which it is received by the CIR for the purposes of attaching imputation credits to
dividends;
(b) From the end of the tax year in which the CIR receives the notice for all other purposes;
(c) If the election is revoked by the CIR, the revocation is effective from the date stipulated in the notice
for the purpose of attaching imputation credits to dividends; and
(d) From the end of the tax year in which the revocation takes place for all other purposes.

(3) Further income tax

Where an Australian imputation credit account company pays further income tax and, at the time of payment,
there is no possibility that the company will, in the future, have an income tax liability, the company may
elect that the payment be converted to a loss available to any company in the same wholly-owned group. The
amount is calculated by dividing the amount of the further income tax (to the extent to which it is not needed
to pay a liability of the company), by the basic rate of company tax (30 per cent).

**670.410 Dividends paid by Australian imputation credit account companies**

[ss OB 60, OB 61, OB 62, OB 63, OB 64; TAA, ss 29(1B),
67(1)(eb), 69(1B), 139A, 142(1)(d)]

Where an Australian company pays a dividend in Australian dollars, for the purposes of the imputation rules,
the amount is calculated as:

\[
\text{Australian dollar value} \times \text{exchange rate}
\]

Where:

“Australian dollar value” is the amount of the dividend in Australian dollars;

“Exchange rate” is the close of trading spot exchange rate for the Australian dollar:

(a) On the day the dividend is declared if that date is no more than three months before the dividend is
paid; or
(b) The day on which the dividend is paid if that day is more than three months after the date on which
the dividend was declared.

Imputation credits are not able to be attached where the dividend is treated as interest under Australian tax
law and is included in the Australian tax return of the company. The benchmark dividend rules do not apply
where the attachment of imputation credits is prohibited for this reason. The restriction applies to dividends
The restriction does not apply where the shares were issued before 21 July 2005, and either the shareholder company or dividend paying company are not members of the same group of companies, or are both non-resident. Nor does it apply where the shareholder acquired the shares before 21 July 2005 for business reasons. The business reasons must fall into one of the following categories:

(a) Part of a share-broking business;
(b) As an investment held as part of an insurance business;
(c) As security given for a loan as part of a money lending business;
(d) As a trustee for a beneficiary who is not a company in the same group of companies as the shareholder.

The business reasons must be independent of the relationship between the shareholder and the dividend paying company [s OB 63].

(1) Shareholder dividend statement
When issuing a dividend statement to shareholders, an Australian company is required to use the words “New Zealand imputation credit” to describe any imputation credit attached to the dividend.

(2) Company dividend statement
Where a dividend is paid in Australian dollars, the exchange rate used to calculate the imputation ratio must be shown on the company dividend statement.

(3) Imputation return
The last date for filing of the imputation return of an Australian imputation company is:

(a) Where the company is not required to file a return of income for the year that corresponds with the tax year (ie to 31 March), is required to file its imputation return by 1 July following the end of the tax year; or
(b) Where the company is required to file a tax return to 31 March, the last day for filing the imputation return is the date by which its income tax return is required to be filed.

Where the company fails to file its imputation return on time, a late filing penalty of $250 is payable. The due date for payment of the penalty is the later of the due date of the imputation return or such date as the CIR may specify. The date specified by the CIR must not be less than 30 days following the date of notification by the CIR.

670.415 Imputation credit account of Australian company [ss OB 27, OB 28, OB 29, OB 57, OB 58, OB 59]
In addition to the debits and credits which arise in the imputation credit account of a New Zealand company, an Australian company must record credit and debit entries.

Credit entries include:
(a) Non-resident withholding tax paid on resident passive income;
(b) Non-resident contractors withholding tax; and
(c) Tax paid for income as a non-resident insurer, shipper or film maker under ss CV 16 or CV 17.

The credits arise on the date of payment of the tax. Only one credit is allowed for any amount of tax payment.

Debit entries include any refund of:
(a) Non-resident withholding tax paid on resident passive income;
(b) Non-resident contractors withholding tax; and
(c) Tax paid in respect of income as a non-resident insurer, shipper or film maker under ss CV 16 or CV 17.

The debits arise on the date of on which the refund is paid.
670.420  **Consolidated imputation groups** [subparts FN and OP; TAA, s 74]

With effect from 1 April 2003, the imputation credit account (ICA) provisions relating to consolidated groups are extended to accommodate imputation groups, including trans-Tasman imputation groups.

1) **Terminology**

Three types of imputation groups are:

(a) “Consolidated imputation group”, which means an imputation group, a resident imputation subgroup, or a consolidated group, no member of which is a member of an imputation group [s YA 1];

(b) “Imputation group”, which means a group formed under s FN 7 [s YA 1, see 670.390];

(c) A “imputation subgroup”, relates to a trans-Tasman imputation group and means the members of the trans-Tasman imputation group that are not Australian imputation companies [s FN 8(2), see 670.390].

2) **Imputation credit accounts**

Where the members of a consolidated group elect to form an imputation group with a company that is not a member of another consolidated group, the ICA of the existing consolidated group is required to be used by the consolidated imputation group [s OP 3].

Where the members of a consolidated group that is a consolidated imputation group elects to form or join an imputation group with a company that includes the members of another consolidated group, the combined imputation group records in its ICA:

(a) All of the debits and credits that are recorded in the ICA of the consolidated group immediately before the election takes effect; and

(b) All of the debits and credits that arise from transactions undertaken by any member of the group after the election take effect [s OP 4].

A resident imputation subgroup that is associated with a trans-Tasman imputation group must record in its ICA all of the debits and credits that:

(a) Are recorded in the ICA of the trans-Tasman group; and

(b) Arise in relation to a company that at the time the debit or credit arises:

(i) Will be a member of the resident imputation subgroup (for debits and credits that arise before the formation of the resident subgroup); and

(ii) Is a member of the subgroup (for debits and credits that arise after the formation of the resident subgroup).

Where the members of an imputation group elect to cease to be an imputation group and to form a consolidated group that is a consolidated imputation group, the consolidated group must continue to use the ICA that was previously used by the imputation group.

The opening balance of the ICA of a consolidated group is:

(a) Nil if the consolidated group is formed during the tax year other than from members of a consolidated imputation group in existence immediately before formation of the consolidated group; or

(b) Where the consolidated imputation group is formed during a tax year from the members of a consolidated imputation group in existence immediately before formation, the amount stated in ss OP 3, OP 4 (see above).

3) **Imputation account entries**

Where a consolidated imputation group has an Australian imputation credit account company as one of its members, a credit arises to the ICA of the group for payments made by the Australian company of non-resident withholding tax, non-resident contractors withholding tax and tax paid for income as a non-resident shipper, non-resident film renter or non-resident general insurer.

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Any refunds of taxes of the type referred to above are debited in the ICA account of the group. The debit arises on the day on which the refund is made.

Also credited to the ICA are the following:

(a) The amount of any payment made by an intermediary into a tax pooling account from funds supplied by the group for that purpose;

(b) The amount of any transfer by an intermediary to the group of an entitlement to funds that are held in a tax pooling account.

(4) Tax refunds

Where a company that is a member of an imputation group is entitled to a refund of tax, the refund must be requested in writing. The requirement that the amount of the refund not exceed the credit balance of the ICA applies as if:

(a) The ICA of the imputation group were the ICA of the company; and

(b) The credit in the ICA for the purposes of s RM 13 were reduced by each refund to a member of the group.

(5) Imputation returns

The nominated company of a consolidated imputation group is required to file an imputation return when the consolidated imputation group:

(a) Ceases to be a consolidated imputation group;

(b) Ceases to be an imputation group and becomes a consolidated group that is a consolidated imputation group; or

(c) Ceases to be a consolidated imputation group and becomes an imputation group.

The nominated company of a resident imputation subgroup is not required to furnish an annual imputation return for the group if the group has no liability to make a payment of further income tax or imputation penalty tax under s OP 6 for that income year [TAA, s 74].
Chapter 710
Income

710.05 Overview
The word “income” is not defined in the ITA 2007. In order for an amount to be “exempt income” it must first be “income”: Commissioner of Inland Revenue v Brierley [1990] 3 NZLR 303, (1990) 12 NZTC 7,184 (CA).

Under the ITA 2007, an amount is not income unless it is included in Part C. However, as this includes “income under ordinary concepts”, what is (and what is not), income remains to a large extent a matter of common law principle.

Once an amount has been determined to fall within the meaning of “income” it is then necessary to determine how it is dealt with under the ITA 2007. Section BD 1 divides “income” into:

(a) Exempt income;
(b) Excluded income;
(c) Non-residents’ foreign-sourced income; and
(d) Assessable income.

Assessable income is income that is not exempt income, excluded income or non-residents’ foreign-sourced income. Only assessable income is subject to tax.
Amounts that are “exempt income” are located in subpart CW (Exempt income) or subpart CZ (terminating provisions).

Amounts that are “excluded income” are located in subpart CX (Excluded income) or subpart CZ (terminating provisions).

### 710.10 Income under ordinary concepts

The income of a person includes any amount that is included in income under ordinary concepts [s CA 1(2)].

A number of receipts are deemed to be included in “income”, but the ITA 2007 does not endeavour to define the term exhaustively. Consequently, the ITA 2007 gives little assistance in deciding whether a particular receipt, not expressly mentioned, is or is not income for income tax purposes. In *Scott v Commissioner of Taxes (New South Wales)* (1933) 3 ATD 142 (NSWSC), it was stated:

> “the word ‘income’ is not a term of art, and what form of receipts are comprehended within it, and what principles are to be applied to ascertain how much of those receipts ought to be treated as income, must be determined in accordance with the ordinary concepts and usages of mankind, except in so far as the statute states or indicates an intention that receipts which are not income in ordinary parlance are to be treated as income or that special rules are to be applied for arriving at the taxable amount of receipts.”

In *Lambe v Inland Revenue Commissioners* (1934) 1 KB 178, the Judge stated that:

> “Income may be of various sorts … but nonetheless the tax is a tax on income. It is a tax on what in one form or another goes into a man’s pocket.”

Income is what comes in, but in order to be taxable it must also be in a money form or capable of being turned into money.

These principles were stressed in *Dawson v Commissioner of Inland Revenue* (1978) 3 NZTC 61,252, (1978) 2 TRNZ 375 (SC), but have been overruled by s CC 7(1) insofar as it makes liable to tax any benefit other than in money form derived in consideration of the lending of money for use in a business where the borrowing is a commercial transaction under which interest would otherwise have been payable at current commercial rates.

Whether a gain is, or is not, income can also be dependent on who derives it. For example, a gain on the sale of a motor vehicle owned by a private individual will generally be a capital gain which is not subject to tax. A gain on the sale of a motor vehicle owned by and used in a business will give rise to a depreciation recovery which is taxable, but any amount above cost price will be a capital gain which is not subject to tax. A gain on the sale of a motor vehicle by a car dealer is revenue in nature and subject to tax.

#### (1) Case law

Decisions of the Courts in English-speaking countries given over the last half-century have built up a body of case law which provides standards for the settlement of most problems concerning the nature of income.

The nature, features, and characteristics of “income” were discussed by Quilliam J in *Reid v Commissioner of Inland Revenue* (1983) 6 NZTC 61,624 (HC). See also *Tennant v Smith (Surveyor of Taxes)* [1892] AC 150 (HL); *Federal Commissioner of Taxation v Dixon* (1952) 86 CLR 540 (HCA); *Scott v Federal Commissioner of Taxation* (1966) 117 CLR 514 (HCA), at 526, per Windeyer J.

In *Beare v Carter* [1940] 2 KB 187, (1940) 23 TC 353, the sum of £300, received in consideration of permission to publish a new edition of a book, was regarded as a capital receipt.

In *Billam v Griffith* (1941) 23 TC 757, a practising barrister had for some years spent his spare time in writing plays with the hope of selling them, but without success until he produced a particular play which ran successfully. In addition to royalties and other receipts from the performance of his play for which no question arose, a lump sum was received for the sale of motion picture rights. The decision of the Commissioners was upheld that the appellant was carrying on the vocation of dramatist, and all sums received were therefore
assessable. Where such a vocation is carried on, it is an ordinary incident of the disposition of plays either to realise them by royalties or by outright sale.
In *Des Blandford Ltd v Commissioner of Inland Revenue* (1983) 6 NZTC 61,605 (HC), it was held that a receipt from the assignment of timber cutting rights was not assessable.

In *Bowcock v Commissioner of Inland Revenue* (1981) 5 NZTC 61,062 (HC), breach of study bond payments were found to be assessable.

In *Brent v Federal Commissioner of Taxation* (1971) 2 ATR 563, (1971) 125 CLR 418, 71 ATC 4,195 (HCA), Mrs Ronald Biggs (wife of the “great train robber”) was held to be assessable in relation to moneys received from her life story, she being held to be retained as an employee consultant rendering services.

In *Commissioner of Inland Revenue v A Taxpayer* (1996) 17 NZTC 12,574 (HC), unrepaid funds stolen from an employer were characterised as income. On appeal in *A Taxpayer v Commissioner of Inland Revenue* (1997) 18 NZTC 13,350 (CA) the stolen funds were held to be not taxable. This matter has now been resolved by legislation [see 710.80].

In *Federal Commissioner of Taxation v Cooke* (1978) 9 ATR 310, 78 ATC 4685 (VSC), it was held that the value of holidays was not assessable.

In *Glasson (Inspector of Taxes) v Rougier* [1944] 1 All ER 535, payment received by an author in consideration of the granting by her of exclusive rights of publication of certain novels was held to be liable to taxation.

In *GPO Holdings Ltd v Commissioner of Inland Revenue* (1996) 17 NZTC 12,429 (HC), a trading profit of $7,641,000 had accumulated over the five months between the execution of a sale and purchase agreement for a business and its settlement. This was payable to the objector on settlement. It was held that only $102,564 of the trading profit was assessable. Until a “nomination agreement” had been entered into, the objector did not have a legally enforceable right to receive trading profits.

In *Hobbs v Hussey (Inspector of Taxes)* [1942] 1 All ER 491 (KB), a solicitor’s clerk, who had never carried on the profession of an author, received a sum of money from a newspaper for the serial rights of his life story. He retained no interest in the copyright of the articles but he did not part with his notes or diaries. He contended that the sum was not a revenue receipt since the transaction was the sale of the copyright of the articles and therefore resulted in the realisation of capital. It was held that the true nature of the transaction was the performance of services, the sale of the copyright being subsidiary thereto, and the sum received was, therefore, assessable as revenue.

The performance of services, though they may involve some subsidiary sale of property, are in their essence of a revenue nature since they are the fruit of an individual’s capacity which may be regarded in a sense as their capital, but are not the capital itself. It is possible that if the appellant had merely sold his notes and diaries, the price obtained for them would have been a receipt of capital, unless it consisted of royalties or similar payments.

In *Mason (Inspector of Taxes) v Innes* [1967] 2 All ER 926 (EWCA Civ), the taxpayer, a well-known and successful author who was about to publish a new book, assigned the rights in the book (valued at £15,425) to his father by way of gift. The taxpayer’s expenses of travelling to the Persian Gulf to gather material for the book were allowed as a deduction from his income for tax purposes, and it was found that the writing of the book and the disposal of the book took place in the course of the carrying on by the taxpayer of his profession of an author. The taxpayer, whose earnings were assessed for income tax purposes on a cash basis, was assessed to tax on the estimated value of the rights in the book assigned to his father as if it were the taxpayer’s income. It was held that the taxpayer was not chargeable to income tax on the gift which he made of the copyright in his book.

In *New Zealand Society of Accountants v Commissioner of Inland Revenue* (1985) 7 NZTC 5,122 (HC), it was held that professional societies setting up fidelity funds for the protection of members of the public were not trust funds for charitable purposes, and income derived by the trusts was assessable. The Court of Appeal in *New Zealand Society of Accountants v Commissioner of Inland Revenue* (1986) 8 NZTC 5,205 (CA) upheld the High Court decision in confirming that the funds lacked the necessary public character to be charitable.
In *Rank Xerox (New Zealand) Ltd v Commissioner of Inland Revenue* (1983) 6 NZTC 61,501 (HC), sale proceeds in excess of the cost of ex-rental equipment were deemed to be assessable.

In *TRA Case E27* (1981) 5 NZTC 59,174, it was held that the full amount of profit on the sale of a leased truck was assessable. This was upheld on appeal: *John Anderson Ltd v Commissioner of Inland Revenue* (1985) 7 NZTC 5,029 (HC).

In *TRA Case E99* (1982) 5 NZTC 59,532, it was held that the sale of scrap machinery was assessable as the intention was to make a profit.

In *TRA Case F43* (1983) 6 NZTC 59,775, an annuity was held to be income even though it was subsequently regarded as advance payments against a lump sum.

In *TRA Case F55* (1983) 6 NZTC 59,481, it was held that income from stock-car racing was not assessable. The taxpayer was engaged in this activity for sport, amusement, and prestige, with hope of casual prize money.

In *Trustees of Earl Haig v Inland Revenue Commissioners* [1939] SC 676, (1939) 22 TC 725 (IH (1 Div)), the amount realised on sale of a diary was held to be a capital receipt. The trustees possessed diaries of unique importance and great value, and the Court’s view was that these diaries were a capital asset and the trustees had realised some part of the asset. The Court did not have to consider the profits received by the author of the book. It could not be said that from the point of view of the trustees the sale was subsidiary to their performance of services.

In *Whitworth Park Coal Co Ltd v Inland Revenue Commissioners* [1959] 3 All ER 703 (HL), it was ruled that account must be taken of trading debts which have not yet been received when computing a trader’s income.

In *Withers (Inspector of Taxes) v Nethersole* [1948] 1 All ER 400 (HL), moneys for motion picture rights for a play written more than 30 years previously were found to have been received by a woman who was not carrying on the vocation of dramatist at the material time. Therefore she could not be assessed for “annual profits or gains” of that profession. It was held that the proceeds were not otherwise taxable because they were not in the nature of royalties, and that for income tax purposes the receipt was a capital one, being for the sale of property with a limited life.

In *TRA Case V1* (2000) 20 NZTC 10,001, Judge Barber found that the nature of an amount of compensation for items of a revenue nature is itself revenue and required to be included in gross income.

### 710.15 Exclusions from income

Some gains are not income in nature. These include such things as windfall gains, gifts, and capital gains.

1. **Windfall gains**

   Windfall gains include gains that are not earned but, rather, arise by virtue of luck, such as a win in a lottery, prizes and inheritances.

2. **Gifts**

   Gifts and payments made by way of personal esteem or testimonial, even if of a recurring nature, are not income. If a payment is in fact a gift, a mere repetition of payments cannot alter their plain character: *Louisson v Commissioner of Taxes* [1942] GLR 477 (CA).

Gifts in kind (not cash gifts) to employees are usually subject to FBT. Whether a cash payment by an employer to an employee is a gift is essentially a question of fact. Generally, a payment which would not have been made had the recipient not been an employee constitutes income to the donee.

In *Walker (Inspector of Taxes) v Carnaby, Harrower, Barham and Pykett* [1970] 1 All ER 502 (Ch), a firm of chartered accountants had been auditors to a group of companies for many years, in one case for 59 years. In 1952 they were told not to seek re-election, and were later given a sum of about £2,500, the equivalent of their fee for the last year of office, as compensation. They had not asked for any compensation, and they objected to being assessed for income tax on the amount. It was held that a voluntary gift made by a former client, not as consideration for services rendered, but by way of recognition of past services or consolation...
for termination of an appointment, was not a receipt of the business which consisted of rendering professional
services.

In Scott v Federal Commissioner of Taxation (1966) 117 CLR 514 (HCA) a loyal client’s gift to a solicitor
was held not to be assessable.

Tips, although of a voluntary nature, arise because of services performed and represent income to the
recipient.

Air New Zealand Airpoints Dollars resulting from expenditure incurred by the member’s employer on work-
related travel by the member and the redemption of those Airpoints Dollars do not result in either income
for the member or an FBT liability for the employer. The conclusions were reached in Product Ruling BR
PRD 09/09 [see TIB vol 21:8 (October /November 2009 at 4-8)].

Financial redress under a Treaty of Waitangi settlement is not income. Compensation paid under the Crown
Forest Assets Act 1989 (other than compensation based on market stumpage) is exempt from tax to the extent
to which it would be income. Similarly, claimant funding provided by the Crown is not income. These
conclusions were reached in an interpretation statement issued by the CIR [see TIB vol 16:10 (November
2004) at 8-30]. The CIR has also issued a statement to the effect that an amount described in the Deed of
Settlement as “interest” is a capital receipt and not taxable [see TIB vol 21:2 (April 2009 at 19-23).

Generally, gifts are not deductible when calculating the net income of the donor. However, forgiveness of
debts can be within the scope of a financial arrangement [see 470 FINANCIAL ARRANGEMENTS].

(3) Capital gains

Capital gains generally are not subject to income tax. Examples include:

(a) Gains from the sale of investment assets such as shares where the taxpayer is not in the business of
dealing in that type of asset and the asset was not acquired for the purpose of resale [see 1340 SHARE
SALES]. However, special rules apply to the sale of certain types of asset. One example is land sales
[see 710.55];

(b) Compensation for loss of a capital item. However, compensation for loss of revenue is, itself, revenue
in nature and subject to tax;

(c) Sale of an asset in excess of cost price [see 250.140]; and

(d) The revaluation of opening herd livestock [see 430.35].

710.20 Income deemed by legislation

In addition to income under ordinary concepts, the ITA 2007 can deem amounts that would ordinarily not
be regarded as “income” to be income for tax purposes. An example of this is certain types of “income” from
land sales [see 880 LAND SALES]. The ITA 2007 can also deem income that legally belongs to one person
to have been derived by another person for tax purposes. An example of this is the attribution of income rules
contained in ss GB 27 to GB 29 [see 740.30].

710.30 Exempt income

Exempt income is income which, but for exemption, would have been liable for income tax: Australian
Mutual Provident Society v Commissioner of Inland Revenue [1961] 3 All ER 1051 (PC). Therefore, before
an item can be “exempt income”, it must first be income according to general concepts: Commissioner of

Subpart CW provides an exemption from tax for a number of different income types [see 370.15]. Further
items of exempt income can be found in subpart CZ (Terminating provisions).

710.35 Excluded income

Subpart CX provides for a number of different income types to be “excluded income” [see 370.25] Further
items of excluded income can be found in subpart CZ (terminating provisions).
Income from employment

Income from employment is subject to tax in a number of different forms.

In addition to normal weekly or monthly cash earnings, the term “salary or wages”, includes such diverse things as:
(a) The value of board or lodgings;
(b) Expenditure on account of an employee;
(c) Any payment to a working partner of a partnership under a contract of service;
(d) Payments of income-tested benefits, veterans’ pensions, New Zealand superannuation, and living alone payments; or
(e) Payments of earnings-related compensation.

These items are subject to deduction of tax at source via the PAYE system [see 1080 PAYE].

Salary or wages paid to a shareholder-employee in a company are, in some circumstances, subject to deduction of PAYE and, in other circumstances, are taxed in the same way as business income which is subject to the provisional tax regime [see 1080.11].

Benefits in kind such as the free use of a motor vehicle, free or subsidised goods or services, and low or interest-free loans are not subject to income tax in the hands of the employee. However, they are subject to fringe benefit tax payable by the employer [see 540 FRINGE BENEFIT TAX].

Whether a benefit item is income in the hands of the employee or a fringe benefit, is most easily determined by deciding who would be sued if the good or service was not paid for. If the answer is the employee, the value of the good or service is likely to be income in the hands of the employee (for example, where the benefit is payment of the employee’s telephone account). If the answer is the employer, the value of the benefit is likely to be subject to FBT (for example, the gift by an employer to an employee of a television set).

Where an employee is a member of a subsidised superannuation fund, the employee’s contributions are paid from tax-paid earnings. However, the employer contribution can be subject to either PAYE or “employer’s superannuation contribution tax” (ESCT). Early withdrawal of superannuation can give rise to superannuation withdrawal tax where a withdrawal is made prior to 1 April 2011 [see 1390 SUPERANNUATION].

Members of the armed forces are subject to special rules [see 50 ARMED FORCES AND POLICE].

Income from hotels and motels — accommodation adjustments

All hotel and motel owners should make adjustments to their incomes on a factual basis that realistically reflects the private use of accommodation goods and services charged to the hotel, motel, or other similar business. The following method can be adopted:

\[(a \div b) \times c \times 50\%
\]

Where:

a is the area of the hotel or motel complex designated as the owner’s quarters;
b is the total area of the hotel or motel complex; and
c is the total expenditure on interest or rent, rates, power, telephone rental, insurance, and all other costs not solely attributable to the owner’s or lessee’s occupancy or to the carrying on of the business.

This formula is appropriate in most situations, but where it is unrealistic the matter should be discussed with the local Inland Revenue.

In *TRA Case C13 (1978) 3 NZTC 60,117, (1978) 2 TRNZ 385*, Inland Revenue, exercising its discretion, increased the value of the accommodation allowance of a manager so that it was based on normal rents for the area subject to reduction for abnormal factors, such as the employee not having any choice of residence. The value of free meals was also taken into account.
710.45  Income from trusts

Whether, and to what extent, a distribution from a trust is subject to tax in the hands of the recipient and the rate of tax that will apply depends on the type of trust that is making the distribution. Note that the term “trust” includes an estate.

If the trust is a “complying trust”, only “beneficiary income” is subject to tax in the hands of the beneficiary. This is taxed at the beneficiary’s marginal tax rate. “Beneficiary income” includes only revenue amounts that have been received by the trustee and which have not already been taxed in the trustee’s hands at the trustee rate of 33 per cent.

If the trust is a “foreign trust”, beneficiaries are taxed, not only on beneficiary income, but also on income derived by the trustee on or after 1 April 1988. Again, the rate of tax payable by the beneficiary is the beneficiary’s marginal tax rate.

If the trust is a “non-complying trust”, beneficiaries are taxed on beneficiary income at their marginal rate of tax. They are also taxed at the rate of 45 per cent on and post 1 April 1988 trustee income and distributions made from capital gains derived by the trustees.

See 1420 TRUSTS AND ESTATES for further explanation.

710.50  Investment income

(1)  Dividends

A dividend is a payment or other benefit provided to a person who is a shareholder in the company. The person’s capacity as a shareholder has to be considered when deciding whether any payment or distribution from, or a transaction with, the company is a dividend. The payment, distribution, or transaction is likely to be a dividend if the terms differ from those that the company would make with someone who was not a shareholder. However, other factors might also indicate that the amount is received in a shareholder capacity.

Dividends are subject to tax in the hands of the shareholder. However, imputation credits may be attached to the dividend giving the shareholder the benefit of tax already paid on the income by the company [see 270 DIVIDENDS and 670 IMPUTATION].

(2)  Foreign sourced income

New Zealand tax residents are subject to tax on their world-wide income. Non-residents are subject to tax only on income which has a New Zealand source. Many foreign investments such as shares in a foreign company or an interest in a foreign superannuation fund or life insurance policy will be subject to tax in New Zealand under the attributed foreign income rules. These rules are broken down into two parts being the “foreign investment fund” rules and the rules relating to “controlled foreign companies” [see 850 INTERNATIONAL TAX REGIME].

(3)  Loans and other financial arrangements

A financial arrangement arises where there is a difference in the amount and timing of the consideration for a transaction passing in one direction and the consideration passing the other way. A simple example is a loan where one party provides money now in exchange for the other party promising to pay a greater sum of money in the future. While the inclusion of interest in a transaction will generally point to a financial arrangement being in existence, this is not always the case. Neither do all financial arrangements involve “interest” in the way in which most people think of the term. The taxation of financial arrangements is a complex issue and is discussed at 470 FINANCIAL ARRANGEMENTS.

(4)  Rental income

Rental income is subject to tax [see 1220 RENT].

710.55  Land sales

In many circumstances, the sale of land will be on capital account and not subject to tax. However, where the taxpayer is in the business of dealing in land, or acquires land with the intention of resale, any profit on sale will be a normal trading profit.
Taxpayers who are in the business of erecting buildings, developing, or subdividing land are subject to tax on the profits if the land is part of their business activities. In addition, these taxpayers and their associates are taxable on profits from land sales where the land has been owned by them for less than 10 years (developers and subdividers) or has been sold within 10 years of the date on which improvements were completed (taxpayers in the business of erecting buildings).

Profits on the sale of land which has been subject to subdivision or development is often taxable in the hands of the person undertaking the subdivision or development activities.

A number of exemptions apply, particularly in relation to the taxpayer’s private dwelling, business premises or premises held for rental purposes.

See 880 LAND SALES for further explanation.

**710.60 Business income**

Income from any business is subject to tax. The taxation of business income is discussed in 130 BUSINESS.

There are a number of tax provisions that apply only to the income of certain industries. These industries include:

(a) Farming [see 430 FARMERS];
(b) Films [see 460 FILM INDUSTRY];
(c) Fishing [see 500 FISHING INDUSTRY];
(d) Forestry [see 520 FORESTRY AND TIMBER];
(e) Life insurers [see 800 INSURANCE];
(f) Mineral mining [see 980 MINING COMPANIES AND OPERATORS];
(g) Petroleum mining [see 980 MINING COMPANIES AND OPERATORS]; and
(h) Superannuation funds [see 1390 SUPERANNUATION].

**710.65 Property acquired for the purpose of selling** [s CB 4]

Where any personal property is acquired by a taxpayer for the purpose of resale, even if it is an isolated transaction unconnected with the normal trade or business, any resulting profit will be taxable and any loss deductible.

The most relevant factor under this limb is the purpose of the taxpayer with respect to the property as at the time of its acquisition: Hazeldine v Commissioner of Inland Revenue [1968] NZLR 747 (SC) and Henderson v Commissioner of Inland Revenue (1982) 5 NZTC 61,279 (HC).

The Courts have made it clear that they are concerned with the dominant purpose of the taxpayer when the entire property is acquired. In Commissioner of Inland Revenue v Walker [1963] NZLR 339 (CA), the taxpayer purchased 63 acres of land adjoining his existing farm. Three acres of the land consisted of road frontage within city limits. The taxpayer resold this three acre portion of land and made a profit. The Court of Appeal held that the profit from this resale was not assessable because the dominant purpose of the taxpayer in purchasing the 63 acres was to enlarge his existing farm. The Court declined to split the purpose of the taxpayer with respect to the three acre frontage and the main part of the land.

However, where the property consists of separate parcels of land or relates to two or more items that are different in character, separate purposes may be adduced by the Courts. In the case of Harkness v Commissioner of Inland Revenue [1975] 2 NZLR 654 (SC), three separate parcels of land were acquired contemporaneously. Two parcels consisted of smaller lots and subdivided sections but the third parcel was an undivided block of land that had not been approved for subdivision. The Court held that the profits from the sale of the two subdivided parcels were assessable but the profits from the sale of the third parcel (which had been subsequently subdivided) were not. The Court reached this decision on the basis of separate purposes.
In *Williams Property Developments Ltd v Commissioner of Inland Revenue* (1980) 4 NZTC 61,537 (CA), the Court of Appeal held that a conditional purpose may be a dominant purpose. In so doing, Richmond P expressed the view that, where a person acquired land believing it would go up in price and able to be resold at a profit, the dominant purpose could be regarded as resale at a profit notwithstanding such purpose was contingent upon a rise in value of the land.

It is clear that s CB 4 contemplates a positive act by the taxpayer in acquiring the property. It has been held by the Courts that the mere inheritance of property is not an acquisition for the purpose of resale and similarly the acceptance of a gift is not sufficient: *McClelland v Federal Commissioner of Taxation* [1971] 1 All ER 969, (1970) 2 ATR 21, 70 ATC 4115 (PC); *Federal Commissioner of Taxation v Williams* (1972) 3 ATR 283 (HCA); and *AG Healing & Co Ltd v Commissioner of Inland Revenue* [1964] NZLR 222 (SC).

In *Commissioner of Inland Revenue v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA), the Court made several important points concerning the provision:

(a) It is necessary to determine whether the dominant purpose in acquiring the property is to sell it at a later date. The test of purpose is subjective. If resale is proposed, it matters not that it is only the means to an end. If the taxpayer’s purpose in acquiring the property is to sell it in the future at a price that (allowing for inflation), corresponds with, or is better than, its price at the time of purchase, their statutory purpose is to sell the property even though the motive is to protect the savings from inflation. The length of time the assets are held is of particular importance when considering purpose of acquisition (a holding period of 19 months for shares is not long-term);

(b) The provision is inapplicable where:

(i) Shares are acquired for the purpose of securing not only income from dividends but also growth in the value of the shares;

(ii) The dominant consideration is to provide and enlarge dividend income; and

(iii) There is solely an intention to buy with an expectation of benefiting financially in an unformulated way and without clear consideration of the advantages of either retention or resale sooner or later.

The property sold must be equivalent to that which was acquired although it need not be in the same condition.

In determining whether sufficient identity of interest exists: see *AG Healing* and *McClelland* (above); *Moruben Gardens Pty Ltd v Federal Commissioner of Taxation* 72 ATC 4147 (HCA); *Cowan v Federal Commissioner of Taxation* (1972) 3 ATR 474 72 ATC 4121 (VSC); and *AL Hamblin Equipment Pty Ltd v Federal Commissioner of Taxation* (1974) 131 CLR 570, (1974) 5 ATR 16 (HCA).

**TaxNote:** The principles of the above cases were not followed in *TRA Case L43* (1989) 11 NZTC 1,262, a case concerning the sale of part of an interest in land.

Many of the above cases concern the sale of land under previous legislation although the principles established remain applicable. In *Commissioner of Inland Revenue v Renouf Corporation Ltd* (1998) 18 NZTC 13,914 (CA), Renouf Corporation Ltd (RCL) took 50 per cent of the shares in Wellington Towers Ltd (WTL), a company set up to develop a city building site, with the intention of ultimately deriving profits by way of dividends. At a later date, RCL acquired a minority interest in Renouf Property Developments Ltd (RPDL) and, in so doing, transferred its beneficial interests (but not the shares themselves) in WTL to RPDL in return for a payment of $2.75 million. The Court of Appeal held that the $2.75 million payment was a capital payment and not income derived from a scheme under s 65(2)(e) of the ITA 1976 [now s CB 4].

**710.70  Profits or gains from any undertaking or scheme** [ss CB 3, DB 26]

Profits from the sale of personal property derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit is income.

A taxpayer who has derived income under s CB 3, from an undertaking or scheme entered into for the purpose of making a profit, is allowed a deduction for the cost of the property as if it were acquired from an unrelated third party immediately after the commencement of the undertaking or scheme for a cost equal to the market value of the property at the time.
Example:
A salary and wage earner, who is also an electronics enthusiast, has become involved in putting together a sound system for a business. She will be paid $30,000 for the system. This is a one-off project and is not likely to be repeated. The enthusiast is not in business. A number of components need to be purchased, but the enthusiast also owns various components that can go into the project. Some of these components originally cost the enthusiast $1,500 but other components were just acquired over a period of time without any record of how much they cost. Some were acquired without cost. The current market value of all of the components is $4,000, which she would have had to spend under other circumstances. As all these components were held personally, and because the income is taxed under s CB 3, a deduction is allowed for an amount of $4,000.

The purpose of the taxpayer must be a dominant purpose, and must be determined not at the time of the acquisition of the property but at the time at which the scheme or undertaking was entered into.

Profits of an income nature and not of a capital nature are assessable. The scheme must produce income and not a capital gain. Hence, the mere realisation of a capital asset to the best advantage as and when circumstances are most favourable is not assessable: McClelland v Federal Commissioner of Taxation [1971] 1 All ER 969, (1970) 2 ATR 21, 70 ATC 4115 (PC); Eunson v Commissioner of Inland Revenue [1963] NZLR 278 (SC); and Beetham v Commissioner of Inland Revenue (1972) 3 ATR 342 (SC). In both the latter cases, farm land which was no longer required and uneconomic was subdivided and sold off.

In Johnstone v Commissioner of Inland Revenue (1985) 7 NZTC 5,068 (HC) the taxpayer’s one-tenth share of profit from the dispoision of land was assessable. At the time of acquiring his interest, the taxpayer had an immediate purpose of making a profit by way of 10 per cent of the proceeds of sale. The taxpayer’s reward for arranging the sale of land was profit from a scheme in the nature of a business deal, and not the realisation of a capital asset.

It appears from the judgment of the Privy Council in McClelland that, before a transaction can be described as a “profit-making undertaking or scheme” within the meaning of s 26(a) of the Income Tax Assessment Act (the Australian equivalent), it must possess features which give it the character of a business deal. However, it is doubtful whether this view represents the New Zealand position. In the case of Beetham, Henry J expressed the view that the Australian legislation differed from the New Zealand legislation in so much as, in the first limb of the New Zealand provision [now s CB 4], the Legislature had expressly provided for business profits. This does not appear in the Australian legislation and this prompted the Court in McClelland to say that the notion of business was implicit in the words undertaking or scheme. Accordingly, an undertaking or scheme may give rise to an assessable profit even though it is uncharacteristic of a normal business venture.

In Wilson v Mannooch [1937] 3 All ER 120 (KB) a solicitor agreed with a builder that, in consideration of the solicitor lending or arranging to lend a sum of money to the builder for the purpose of buying a property, the solicitor should receive on its resale one-third of the profit with a limit of £1,000. There was another isolated transaction of the same nature. It was held that the sums received by the solicitor were assessable.

In IT Case No 640 (1947) 15 SATC 229 the taxpayer paid $500 for the option to buy a property for $40,000, the period of the option being about three weeks. Before the expiry of that period, the taxpayer assigned his option for $10,000. The taxpayer, who was assessed for the profit, claimed that he had intended to acquire the property as an income-producing investment. He had previously been engaged in the business and during the relevant year was a farmer. It was held that the profit was assessable.

710.75 Goodwill

Goodwill can be either taxable as income or non-taxable as a capital gain depending on the circumstances.

A capital gain will arise where the goodwill relates to:
(a) The sale of a lease unless the business of the taxpayer includes dealing in leases; or
(b) The sale of a business where the goodwill relates to the personal esteem of its customers.

Goodwill is taxable when received by an owner of land from any lease affecting the land. The amount received or the goodwill of the lease of licensed premises is the typical instance of goodwill being income [see 600.10].
710.80 Property obtained illegally [ss CB 32, DB 44]

Property obtained illegally is termed “possession or control of property without claim of right” and is included in the meaning of income [s CB 32]. A payment of restitution relating to property obtained without a claim of right is an allowable deduction [s DB 44]. The income is allocated to the year in which the property is obtained. The deduction is allocated to the income year in which the person makes restitution. A claim of right means:

“A belief that an act is lawful, although the belief may be based on ignorance, or mistake, of:

(a) Fact; or

(b) Any matter of law other than the enactment against which the offence is alleged to have been committed.”

An example of a transaction caught by this section would be funds obtained by fraud.

These provisions overcome the effect of A Taxpayer v Commissioner of Inland Revenue (1997) 18 NZTC 13,350 (CA) where the Court of Appeal held that the proceeds from criminal activity for financial gain are not income.

710.83 Child support and maintenance [s CW 32]

Child support and spousal maintenance under the Child Support Act 1991, and payments in the nature of maintenance received from a person’s spouse [see 960.10] or former spouse, are exempt income to the recipient. The paying spouse is not entitled to a deduction for the alimony or maintenance payments [s DA 2(2)]. This applies when a person pays the maintenance direct to the spouse, or former spouse, under a verbal or written agreement, or in compliance with a Court order, or where it is paid into Court.

Where assets are assigned absolutely to the spouse or to a trust to provide for the alimony or maintenance, the income is not payable out of moneys belonging to the person, and the amount received is not exempt: Dunn v Commissioner of Inland Revenue (1974) 1 NZTC 61,245, (1975) 1 TRNZ 9 (SC).

In TRA Case H25 (1986) 8 NZTC 251, a taxpayer wife and husband entered into a relationship property deed providing inter alia for the wife to receive $40,000 at a future date and, pending its receipt, the wife would receive interest on the principal sum. No maintenance was sought. The TRA ruled that for income to be exempt it must relate to payments “in the nature of maintenance” but, in this case, the deed clearly stated that the payments were for interest and nothing else. Consequently the payments could not be considered to be “in the nature of maintenance”.

Where a trust has been created by a person for the payment of maintenance, any amounts paid by the trustees from dividends retain their character as dividend income in the hands of the beneficiary, notwithstanding that they form part of the maintenance. The payments will also fall within the definition of annuity. Therefore if, in order to meet the full amount of the alimony, the trustee is compelled to resort to capital funds, the provisions of subpart HC do not apply. Such amounts form part of the annuity and are therefore assessable, even though paid out of capital funds. Section CC 5 specifically includes annuities as income.

A Court order, a deed, or an agreement, may provide for payment of alimony or maintenance to a spouse or former spouse for life, and binds the executor or administrator of the person making the payment to continue the payments after the death of the paying spouse. Such maintenance or alimony payments continue to be exempt income to the recipient: Ager v Commissioner of Inland Revenue (1988) 10 NZTC 5,175 (CA).

Alimony or maintenance payments made by the trustee of the estate are not deductible in calculating the net income derived by the trustee, and any income used to pay the alimony or maintenance is assessable to the trust. The recipient of the alimony or maintenance payment is not a beneficiary in the estate but is a creditor entitled to payment out of the estate by virtue of the Court order, deed, or agreement.

710.85 Home-based services [ss CW 61, DA 2(3)]

The CIR has the ability to determine a service performed by a natural person in their home, which involves duties normally carried out in a family household, to be a “standard-cost household service”. Taxpayers who derive income from a “standard-cost household service”, will have the option of either using the CIR’s
determinations, in which case the income derived is exempt from tax, or calculating their profit in the normal way.

Under s 91AA of the TAA, the CIR has the power to determine the following matters:

(a) The requirements for exemption under s CW 61 of income from standard-cost household services;
(b) The cost of earning the exempt income or a method of determining that cost. Taxpayers using this option are precluded from claiming any deductions in respect of the income; and
(c) That a standard cost can be applied against the income derived from the provision of the services or a method of determining that cost. Taxpayers may use the standard cost instead of the actual deductions.

No losses are allowed if standard costs are used as the income is exempt income [s DA 2(3)].

Determination DET 001: Standard-Cost Household Services for Childcare Providers sets out the rules for standard cost household services for childcare providers and the standard cost available to taxpayers providing standard cost household services [see 230.140, TIB vol 16:4 (May 2004) at 18-21].

Determination DET 05/03: Standard-Cost Household Service for Boarding Service Providers sets out the rules for standard cost household services for boarding service providers and the standard cost deductions available to taxpayers providing standard cost household services [see 230.143, TIB vol 17:10 (December 2005) at 54-64].

710.90 Scholarships and bursaries [s CW 36]

In TRA Case G56 (1985) 7 NZTC 1,247, the taxpayer received a bursary and became an employee of the Post Office. He was a full-time university student and was paid on the basis of the full salary that he would have received if he had been working full time. It was held that the bursary came under what is now s CW 36 and therefore the payments were not assessable. On appeal, the decision was reversed: Commissioner of Inland Revenue v Drew (1988) 10 NZTC 5,060 (HC). The Court held that the agreement referred to an employee/employer relationship and that the principal purpose of the bursary payments had been to secure the taxpayer’s services to the Post Office, the educational assistance being of a secondary nature. By choosing a salary option subject to PAYE and not a tax-free lump sum option, the taxpayer had accepted an income tax liability. Section CW 36 did not apply. See also Reid v Commissioner of Inland Revenue (1985) 7 NZTC 5,176 (CA).

In TRA Case M130 (1990) 12 NZTC 2,846, (1990) 15 TRNZ 289, the payment of a bursary that had a condition bonding the recipient to continue working for the payer for a period of three years after attaining a degree was treated as income not merely as monetary remuneration if that were a ground for assessment, but as income according to ordinary concepts.

Where an entitlement to an overseas postgraduate study grant accrued in consideration of certain prior services in New Zealand, the grant was income derived in New Zealand under s 243(2)(r) ITA 1976 (now s YD 4): TRA Case H6 (1986) 8 NZTC 147.

In TRA Case P23 (1992) 14 NZTC 4,166, (1992) 16 TRNZ 670, a financial analyst employed by the Department of State received a grant of $9,136.23 to complete his university studies in law and had PAYE amounting to $1,846 deducted. The analyst objected and contended that the money so received was within the scope of s 61(37) of the ITA 1976 (now s CW 36) and was therefore exempt. The objection was allowed as the objector was not an employee at the time he received money from the employer even though he did come to be employed pursuant to an entirely separate employment contract later on. The reference to the objector in the first agreement as a “study awardee” was merely a formula adopted by the parties to describe the identity and status of the objector. The “agreement for assistance” was not a contract of employment between objector and employer. The objector did no work of any description for the employer during the term of the assistance agreement. In providing the objector with funds to complete his law degree, the employer was not utilising the objector as a prospective employee other than in general terms. The monies paid to the objector were only an allowance for his attendance at an educational institution and were therefore within the exemption allowed for under s CW 36.
710.95  **Restrictive covenants and inducement payments**

A restrictive covenant payment is the consideration given for a restriction on a person’s right to perform services. An inducement payment is the consideration given by a prospective employer or contractor to a person to give up a particular status or position. Special tax rules apply to such payments [see 1265 RESTRICTIVE COVENANTS AND EXIT INDUCEMENTS].

710.100  **Authors’ income** [ss CC 9(1), EI 3]

Royalties constitute income. Royalties paid to authors by instalments over a period of years are assessable even though they may be instalments of the purchase price paid for the copyright. Where a lump sum payment is received, the treatment of that lump sum for taxation purposes depends on whether payment is for the performance of a service or the sale of property (ie the copyright).

An author’s receipts may take various forms, including:

(a) The sale of the manuscript, when completed, and the copyright in it, for a cash payment and a series of instalments of the sale price based on the sales of the work. In this case the agreement with the publisher is, in essence, an agreement to perform services and to be remunerated with royalties. The receipts (both the cash payment and the royalties) are income.

(b) The sale of the right to publish the work, but retain the copyright, in consideration of a cash payment together with royalties based on the sales of the work. In this case the writer is deriving income from the capital asset (ie the copyright) which is “farmed out” for profit (ie royalties). The writer’s receipts are income.

(c) The sale of the completed manuscript and the copyright in it for a fixed sum. It makes no difference whether it be by way of a lump sum, or payable in part by an instalment on handing over the completed manuscript, in part on publication, and in part by other instalments until the total sum agreed on has been paid. It is also not dependent on the number of sales of the work. In any of these cases, the writer is selling a capital asset and is not assessable for income tax thereon, unless the author’s occupation is authorship. If the author’s occupation is authorship, they would be held to be carrying on the business or vocation of a writer and the receipts would be assessable as such.

Under s EI 3 where an author of a literary, dramatic, musical, or artistic work is engaged on the work for more than 12 months, and receives a lump sum payment for the assignment of the copyright therein, or for the grant of an interest in the copyright by licence, on application the CIR may apportion that lump sum (which would otherwise be taxable in full in the year of receipt) for assessment purposes over the year of receipt and:

(a) The immediately preceding income year where the author was engaged on the work for two years or less; or

(b) The two income years immediately preceding the year of receipt where the author was engaged on the work for more than two years.

The application must be made in writing not later than six years after the end of the income year of receipt. Where the author derives any such payments that are not lump sum payments within two years after the first publication of the work, which would otherwise be assessable in full in one income year, the person may, on written application to the CIR within eight years after the first publication, apportion the payments equally between the year of receipt and the preceding year. This is intended to meet the position where the taxpayer receives peak royalties in the period following the first publication of the work. To give effect to this provision, the CIR is authorised to amend any assessment at any time.

The following further points are relevant:

(a) “Author” includes a joint author. It also applies to playwrights, composers, sculptors, and artists whose work is exhibited.

(b) “Lump sum payment” includes an advance on account of royalties.
(c) As regards the degree of proof required that the work took more than 12 months to produce (or more than 24 months, as the case may be), taxpayers are asked to state the dates (or approximate dates) on which the work was commenced and completed and to state also the name of any person (other than a family member) who is in a position to confirm those dates. If no confirmation is available, the taxpayer can be asked to furnish a statutory declaration. In the case of ordinary royalty payments, where the spread is dependent on their receipt within two years of first publication, taxpayers are asked to supply the actual date on which the work was first published, performed etc, and the name of the publisher (for literary works) or equivalent particulars (for other works). Expenses, including travelling expenses, must be incurred to enable the author to write the book. TRA Case D56 (1980) 4 NZTC 60,845, (1980) 4 TRNZ 165, provides useful guidelines on when an author’s travelling expenses are tax deductible.

(d) The concession afforded by s EI 3 also applies when an author publishes their own work, so that the peak income (usually received in the period following the first publication of the work), can be apportioned between that income year and the immediately preceding income year.

Royalties paid to authors are payments made for the right to publish and are not fees for services rendered. The payments constitute income other than salary or wages and are therefore not subject to PAYE tax deductions at the source. The author must pay provisional tax on the income. The sale of broadcasting rights in plays written by the taxpayer constitute income.

In TRA Case D56 (1980) 4 NZTC 60,845, (1980) 4 TRNZ 165 the dominant motive of the author in undertaking travel was to obtain the latest and most authoritative information on the subject being written and derivation of income from the book would not have followed had not the information been included, travelling expenses could be deductible. The nexus between the expenditure and the production of income was directly related and therefore deductible. However, the TRA sounded a note of caution, observing that the matter may have been seen in a different light had the author not engaged in updating a book in their special field and had merely incurred the travelling expenses in keeping in touch with developments. The cost of works of reference may be deducted if they are required for the purposes of writing the book. If there is a residual value, the deduction should be reduced by any value that exists.

710.105 Clergy

The income of a member of the clergy includes the gross stipend (basic salary) and the value of housing provided. The taxable value of housing supplied is one-tenth of the stipend less 15 per cent (which takes account of that part of the home used for vocational purposes). Gifts or unsolicited contributions from adherents to preachers are assessable, particularly if the preachers are not employed by the Church. In such cases the receipts are income, and associated expenses may be claimed as a deduction. The income is provisional income. The expenses of the preacher’s spouse [see 960.10] may be deductible to the preacher if the CIR is satisfied that an express invitation was made for the spouse to accompany the preacher as part of the preacher’s duties and that the congregation increased their gifts to cover the expenses of both husband and wife.

Under s CW 25 exempt income includes the value of personal board and lodging and other basic personal necessities received by a person whose sole occupation is in the service of a religious society, where the conditions of service are such that no payment or other rewards (other than those necessities) are given for those services.

Income of missionaries on furlough is deemed to relate to their activities in the foreign mission field and is, therefore, not liable for New Zealand income tax. However, if the activities of missionaries on furlough extend beyond genuine reporting by preaching, or by taking employment in New Zealand, the income is assessable.

Income derived by a fund created for the benefit of retired ministers is exempt: Presbyterian Church of New Zealand Beneficiary Fund v Commissioner of Inland Revenue (1994) 16 NZTC 11,185 (HC).
Chapter 740

Income Assigned or Alienated

740.10 Assignments of professional income

The leading case regarding the assignment of professional income is *Hadlee v Commissioner of Inland Revenue* (1989) 11 NZTC 6,155 (HC), where a partner in an accounting firm held 32 units out of a total of 452 in the partnership and, in 1981, assigned 12.8 units, for consideration, to a family trust (the trustee of which was a private company of which the subscribers and directors were partners of the partnership). In the 1981 and 1982 income years, the appellant returned income from 19.2 units and the trust returned income from 12.8 units. The arrangement was considered void by the CIR. The High Court held:

(a) There was in equity a valid assignment of an expectancy for consideration which took effect from the date on which income passed into the hands of the assignor;

(b) Partnership earnings were not solely the produce of the capital of the partnership and what was at issue was an assignment of income from personal services;

(c) The doctrine that income resulting from personal activities is incapable of assignment was approved;

(d) By virtue of the findings in paragraph (a) above, s 96 of the ITA 1976 [which became s FC 11 of the ITA 1994, now repealed] was not relevant, there being no subject matter assigned which arose from the ownership of property; and

(e) The general anti-avoidance provision, s 99 of the ITA 1976 [now s BG 1], was applicable and accordingly “the arrangement” was void.

The High Court decision was confirmed in *Hadlee v Commissioner of Inland Revenue* (1991) 13 NZTC 8,116 (CA) and *Hadlee v Commissioner of Inland Revenue* [1993] 2 NZLR 385 (PC). The Privy Council was in complete agreement with the conclusion that the income is derived by the person whose personal exertion earns it. Therefore, they held the deed of assignment to be ineffective in transferring the tax liability to the assignee. By implication, their Lordships accepted that there may well be a valid assignment of income and transfer of tax liability to an assignee where a partner’s right in a professional partnership depends upon a proprietary interest in the partnership, and not on personal exertion.

Income which is earned from personal exertion is unable to be assigned: *TRA Case S4* (1995) 17 NZTC 7,021.

740.15 Assignment of salary, wages, and royalties

Salary or wages cannot be assigned so as to render the assignor exempt from tax. Remuneration for services is derived by the person who performs the services. Any assignment of the right to receive payment is merely an application of the income after it is derived.
This must be contrasted with the High Court decision in *Webb v Commissioner of Inland Revenue* (1983) 6 NZTC 61,718, (1983) 7 TRNZ 49 (HC), where the taxpayers were university lecturers who published legal textbooks. The taxpayers assigned the royalty income derived to a trust for their children. The CIR issued amended assessments by adding back royalty income on the basis that royalties were paid for personal services which could not be the subject of an assignment. The taxpayers objected and the High Court held that the personal activities of the taxpayers did not effectively cause the royalties to be payable. The cause was the point of sale of texts which was an activity of the publisher. The taxpayers had effected an absolute assignment.

### 740.20 Assignment for benefit of creditors

Where a taxpayer assigns property to trustees in trust for creditors, and the creditors, in effect, agree to accept the dividends received from the trustees in satisfaction of their claims and to relinquish the debtor from personal liability, the income received by the trustees is, in general, assessed as trustee income.

Where the taxpayer’s services are retained in the business by the trustees and the settlor is paid for these services, the payments are regarded as salary and the appropriate PAYE tax deductions must be made by the trustees as employer. However, where the deed is not a deed of assignment but is, in reality, a deed of supervision under which the creditors merely appoint a person to supervise the management of the business, the profits of the business are still the income of the debtor. Accordingly, the debtor is assessable in the normal way on any profits derived. Any relinquishment of debt has potential consequences to the debtor by giving rise to income under the financial arrangements legislation.

### 740.25 Assignment of income to charities

The CIR is sometimes asked to approve schemes for donations in the form of assignments of income (eg interest, rents, dividends) for limited periods for charitable purposes. In some cases, farmers have undertaken that they will hold a stated number of livestock for a period and pay the income to or for the benefit of the charities or a particular charity. While it is not disputed that the donors, in consenting to such arrangements, may have a genuine desire to benefit the particular charities, they cannot escape taxation on the income so assigned. Further, it is not possible to assign future income:

> “As it is impossible for anyone to own something that does not exist, it is impossible for anyone to make a present gift of such a thing to another person, however sure he may be that it will come into existence and will then be his to give. He can, of course, promise that when the thing is his he will make it over to the intended donee. But in the meantime he may change his mind and when the time comes refuse to carry out his promise, even though it were by deed. A court of law could not compel him to perform it. A court of equity would not.” (Windeyer J in *Norman v Federal Commissioner of Taxation* (1963) 9 AITR 85 (HCA)).

To be immune from attack, the assignment or settlement of income must be accompanied by the transfer of the beneficial ownership of the corpus. An exception is an assignment or settlement under which the income is payable to, or to be applied for, any person during the whole of the assignee’s life. However, it is possible to assign the right to income without transferring the corpus.

The CIR has indicated it will be satisfied that schemes involving farmers, livestock, and recognised charities will not be liable to attack if the following elements exist:

(a) Transfer of livestock from farmer to charity is at market values and such values are returned by the farmer as gross income;

(b) Livestock transferred are to be separately identified by an earmark or other permanent mark belonging exclusively to the charity;

(c) Produce which is identified as being from those livestock will belong to the charity and sales must be made in the name of the charity;

(d) Progeny of the livestock must be separately identified;

(e) Livestock originally transferred and retained progeny are the property of the charity and any sales must be made in the name of the charity;
(f) If the livestock are replaced by the farmer, the cycle commencing with paragraph (a) above, starts again for the replacement livestock; and

(g) The charity must keep separate and complete records of all transactions just as an individual farmer would do.

740.27 Evidence of ownership

Taxpayers should ensure explicit evidence exists to ensure ownership of income producing assets is authentic and, if necessary, documented. For example, it cannot be presumed that income earned by assets held in the name of a person may be assessed for tax in the name of that person’s spouse [see 960.10]. The interest on a debenture in the name of Mr Smith is not able to be assessed to Mrs Smith without either the divesting of assets or the alienation or assignment of that income before it is earned.

In TRA Case M113 (1990) 12 NZTC 2,729, (1990) 15 TRNZ 91, an Inland Revenue officer had advised the winners of a Golden Kiwi lottery ticket that the interest income derived from investments could be split between the objectors (a husband and wife) and also between two daughters. The TRA held that Inland Revenue was entitled, in the absence of any explicit arrangement before the purchase of the ticket or the formal disposition afterwards, to reassess the income so that it was derived by the husband and wife.

An explicit arrangement can include: a relationship property split, a gifting arrangement, a sale and purchase agreement, an assignment or alienation of property by deed, a deed of trust, or a succession through inheritance by will or intestacy. These explicit arrangements are available for the legal rearrangement or divesting of a person’s capital and should be authentically performed as (if they are presumed), they are of no legal effect. Gift duty may arise when the title to an asset passes to another person through gifting.

740.30 Attribution of income [ss CE 8, DC 8]

The attribution of income rules were enacted with effect from the income year beginning 1 April 2000 to coincide with the raising of the top personal income tax rate to 39 per cent for income over $60,000. The rules apply where an entity such as a company, trust or partnership (“the associated entity”) is interposed between a person providing personal services (“the working person”) and the user of those services (“the buyer”). Where certain criteria are met, the rules deem the provider of the effort, and not the intermediary, to have derived the income from the services.
Example:
An employee has a salary of $100,000 per annum. Using the tax rates that apply for the 2011-12 income year, the total tax payable on the salary is $23,850. By interposing a company so that the $100,000 is received by the company (which has a 28 per cent tax rate) and taking a salary of any amount less than $100,000, the total combined income tax liability is reduced. For example, a salary of $70,000 would result in a saving of $1,500. A salary of $80,000 would result in a saving of $1,000.

The income that is attributed to the working person is the net income from the activity carried out by the associated entity thereby ensuring that expenses incurred by the associated entity are deductible to the working person. The amount attributed is income to the working person and an allowable deduction to the associated entity.

740.35 Criteria to be met [ss GB 27, GB 28]
The attribution of income rules apply only where all these five criteria are met:
(a) The working person and the associated entity are associated persons;
(b) At least 80 per cent of the associated entity’s income from personal services during the income year is derived through services provided to Person A or a person associated with Person A (ie the same customer or related customers);
(c) At least 80 per cent of the associated entity’s gross income from personal services during the income year is derived through services personally performed by the working person or a relative of the working person or a combination of them;
(d) The working person’s net income for the income year, after the application of the attribution rules, would be more than $70,000 (including the value of fringe benefits) ($60,000 prior to the 2008-2009 income year); and
(e) Substantial business assets are not a necessary part of the business structure that is used to derive the gross income concerned.

“Associated person” is defined in subpart YB at the time at which the services are performed.
The term “substantial business assets” is defined in s GB 28(6) as being depreciable property costing more than $75,000, or 25 per cent or more of the associated entity’s total income from services for the income year, and where not more than 20 percent of the use of the asset is for private purposes. The rules for calculating the private use percentage [s GB 28(9)] provide for calculation based on either the number of days in which FBT is payable as a percentage of the number of days on which the asset is owned or leased or, where FBT is not applicable to the asset, the proportion of operating expenditure that is non-deductible.
The attribution rules do not apply:

(a) Where both “the associated entity” and “the working person” are non-residents during all of the associated entity’s income year;

(b) If the associated entity is a natural person and is neither a partner of a partnership nor a trustee of a trust; or

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

Where the associated entity is a CFC and the amount is an "attributable CFC amount" under s EX 20B(3)(h) [see 850.83], it is taxed under the CFC rules [see 850].

740.40 Calculation of the amount attributed [ss GB 27, GB 29]

Under the attribution rules, the associated entity must attribute to the working person the least of the following amounts:

(a) The associated entity’s net income from services;

(b) The associated entity’s net income;

(c) If the associated entity is a company or a trust, the associated entity’s net income reduced by losses brought forward. This provision applies only where those losses relate to the business of providing services. Losses from other group companies cannot be used to reduce the amount to be attributed.

Further rules for calculating the amount to be attributed are as follows:

(a) If the associated entity is a trust, the trustees are treated as not having made a distribution of beneficiary income to a beneficiary during the income year or before the end of six months after the end of the income year. The amount to be attributed is then reduced by the amount of any beneficiary income that has been distributed to the working person;

(b) If the associated entity is a trust and the amount attributable would cause the trust to have a net loss for the income year, the trust’s beneficiary income for that income year is reduced so that the trust’s taxable income for the income year is zero. The amount of beneficiary income distributed to persons other than the working person is then reduced according to the proportions determined by the trustees. If the trustees do not make such a determination, the amount is reduced proportionately;

(c) If the associated entity is a partnership, the associated entity is to be treated as if it were a taxpayer. The amount to be attributed is then reduced by the amount of any partnership income that has been received by the working person. If a partner in a partnership provides administrative services to a partnership that is subject to the attribution rule, the amount to be attributed is reduced by the market value of those services. This will often apply in a husband/wife partnership where one spouse [see 960.10] provides the services to customers of the partnership and the other spouse attends to bookkeeping and other administrative duties;

(d) If “the associated entity” is a company, the amount to be attributed is reduced by the amount of any dividends paid to "the working person" during the income year or within six months following the end of the income year where those dividends relate to that year’s income;

(e) Any remuneration package provided by the associated entity to the working person is allowed as a deduction in calculating the amount to be attributed. This includes wages, salary, directors fees, attributable fringe benefits and FBT on those benefits;

(f) Where there is more than one the working person in relation to the associated entity the amount to be attributed is to be fairly divided between them based on the relative value of work performed by each of them; and

(g) Where the total amount to be attributed by the associated entity to the working person is less than $5,000 the attribution rules do not apply. However, if there is more than one the associated entity in relation to a the working person the $5,000 exclusion applies only once.
For worked examples of the calculations [see TIB vol 12:12 (December 2000) at 54-57].

740.45 Effect on company imputation and dividends [ss OB 16, GB 27(4)]

Under the attribution of income rules, where amounts have been attributed by a company, the company is allowed a deduction for the amount attributed. However, from a commercial perspective, nothing has happened and the company retains the funds that it may later wish to distribute by way of dividend. As the income has been taxed in the hands of the person to whom it was attributed, the company will not have imputation credits to attach to the dividends. To solve this problem, 42.86 per cent of the amount of the attributed income is allowed as a credit to the company’s imputation credit account. This credit arises on 31 March of the year in which the attribution occurs.

Where the company’s financial statements are adjusted to reflect the attribution (eg by way of crediting the shareholder’s current account with the attributed amount), the additional imputation credit is cancelled.

From 1 October 2007, where the company actually pays a dividend to the shareholder, the company has a choice under s GB 27(4) to treat the dividend as if it was a dividend being paid by a qualifying company [see 1160.65]. To the extent to which the dividend would have had an imputation credit attached to it had the election to treat the dividend as a qualifying company dividend not been made, the credit is cancelled immediately before the payment of the dividend.

In order to access this concession, the company must meet all of the following criteria:

(a) Choose to have the dividend treated as if it were paid by a qualifying company;
(b) Not be a qualifying company; and
(c) Must have no net income for the tax year in which it pays the dividend which is not attributed income under the attribution rules, other than interest income that is merely incidental to the business.

740.50 Effect on provisional tax [s RC 34]

Where the taxpayers concerned anticipated that the attribution rules would apply, and in fact they do not apply, the associated entity may have paid too little provisional tax and the working person may have paid too much. The opposite would apply where the taxpayers failed to anticipate that the rules would apply.

Section RC 34 alleviates this problem. The section provides that, where the associated entity has paid provisional tax in excess of the residual income tax for the year, the associated entity may allocate all or part of that excess to the working person to the extent necessary to cancel out the working person’s provisional tax shortfall. The opposite applies where it is the working person who has paid too much provisional tax and the associated entity who has paid too little. The transfer can take place only on or after the later of:

(a) The day on which the excess tax was paid; and
(b) The day on which the first instalment of provisional tax becomes due and payable by the taxpayer making the allocation.

The allocation is made by giving the CIR notice in writing, within the time within which the return of income must be furnished by the person to whom the excess is allocated, or within such further time as CIR may allow [see 1150.33].
Chapter 750
Income — When Derived

750.10 Meaning of derived [s BD 3]

Income is taxable in the year in which it is derived. This is not necessarily the same year as that in which it is received. The Courts have developed a series of principles, largely based on accounting principles, to determine when an amount of income is derived.

In determining the timing of derivation, the ITA 2007 requires regard to be had to case law and specifically recognises the fact that the cash basis is appropriate for some taxpayers while the accruals basis is appropriate for others. The ITA 2007 also modifies some of the principles laid down by the courts to ensure that the income and related allowable deductions are matched.

(1) Cash basis

Derivation under the cash basis is determined by receipt. This basis is applicable to wage and salary earners and interest receipts in relation to cash basis holders of financial arrangements. However, the cash basis is modified by s BD 3, which deems an amount of income to be derived by a taxpayer if it is credited in their account or, in some other way, dealt with in the interest or on their behalf.

(2) Accrual basis

The accrual basis is normally applied to taxpayers carrying on a business. Under ordinary principles, derivation under the accrual basis occurs when a taxpayer has earned an amount or has an enforceable debt. This basis adopts commercial accounting principles for the recognition of revenues and takes little account of when the income is actually received: Commissioner of Inland Revenue v Farmers Trading Co Ltd (1989) 11 NZTC 6,007, (1988) 12 TRNZ 549 (CA); Arthur Murray (New South Wales) Pty Ltd v Federal Commissioner of Taxation (1965) 114 CLR 314 (HCA); Fincon (Construction) Ltd v Commissioner of Inland Revenue [1970] NZLR 462 (CA); Commissioner of Inland Revenue v National Bank of New Zealand Ltd (1976) 2 NZTC 61,150 (1976) 2 TRNZ 70 (CA).

750.15 Cheque payments

Where income is received by way of cheque, it is the date of receipt of the cheque and not the date of presentation that is crucial. In Ullrich v Commissioner of Inland Revenue [1964] NZLR 386 (SC), the taxpayer received in one income year a rental cheque which he did not present for payment until a later income year. The proceeds were held to be income properly assessable in the income year in which the cheque was physically received.
Barristers, but not solicitors, may furnish their returns on a cash basis. Claims for bad debts cannot be allowed where the income shown in previous returns has been made up from cash receipts only, as to do so would give rise to a double deduction.

Doctors

Returns may be made on a cash or earnings basis.

Doctors who agree to render medical services in the area prescribed in return for the remuneration stipulated in the agreement with the Minister of Health are not servants of the Crown but are independent contractors. Medical bursaries, other than full salary, provided by hospital boards to doctors employed by the boards to enable them to undertake special courses of study or training, are exempt [s CW 36].

The New Zealand Medical Research Council periodically provides foreign study leave for its medical staff for the purpose of bringing them up to date in overseas techniques, rather than as a means of study for a higher degree. It provides specifically for the New Zealand salary payable in full, a costs of living allowance, and full reimbursement for return fares of the recipient and the spouse [see 960.10] in return for an undertaking to remain in the service of the Council for two years after returning to New Zealand. Only the salary is taxable, the other receipts are reimbursements and not taxable.

Post-graduate study grants paid to junior medical staff to encourage them to give service in public hospitals after graduation are income when received. Any travel allowance portion of the grant is considered to be reimbursing and exempt. Junior medical officers absent overseas are to be treated as being in the service of the New Zealand Government and, therefore, resident in New Zealand.

Business income

The Court of Appeal in Commissioner of Inland Revenue v Farmers Trading Co Ltd [1982] 1 NZLR 449, (1982) 5 NZTC 61,200 (CA) comprehensively reviewed, inter alia, the taxation treatment of items sold on credit. The Court found that, where there is an outright sale of trading stock, the entire profit from the sale is required to be returned in that income year. The income earning process has been completed at that point in time.

Professional income

In Henderson v Federal Commissioner of Taxation (1970) 1 ATR 133 (HCA), the correct basis of returning the income of a professional practice, except for doctors and barristers, is the earnings or accrual basis, not the cash receipts basis.

The following general principles apply to businesses where services are provided. This includes accountants, architects, chiropractors, consultants, contractors, engineers, solicitors, surveyors, and veterinarians. Medical practitioners and barristers sole are not subject to these rules.

The income is derived when there is entitlement to bill. The different situations that may arise are set out below, together with an explanation as to when the income is earned. An express agreement may be in writing or oral.

When an express agreement exists, income is earned in terms of the agreement. The income may be derived either during the term of the agreement or at the completion of it, depending on when the agreement provides for entitlement to bill.

When no express agreement exists, but it is customary for the taxpayer to make progress billings, or it is acceptable to the client that progress billings can be made, the income is derived at such intervals as an entitlement to bill arises. When no express agreement exists and it is not customary for the taxpayer to make progress billings, or where the client does not agree to progress billings, the income is not earned until the client’s work is completed and an entitlement to bill is reached.

An “entitlement to bill” may occur either progressively and/or on completion. If, at balance date, there is an entitlement to bill but a bill has not been issued, the income is earned. This is regardless of when the bill is
dated or issued. Even though the determination of the quantum may occur after balance date following
assessment of hours and charge-out, and perhaps after discussion with the client regarding the fee, the income
has been derived as at balance date.

750.40 Directors’ fees
Where the fees are credited to the director’s current account, the CIR assumes that the director concerned is
able to operate the current account and make withdrawals at will. Where this assumption is correct, the
director’s fees are receivable when credited and properly represent income at that stage.
The fees may be paid or credited or otherwise dealt with in the income year following that in which the
services were given. In such cases they should generally be included as income in that following year.
However, where the taxpayer has followed the practice in past years of returning the fees as income of the
year in which the services were given, the CIR generally does not require a change to the cash basis.

750.45 Progress payments
Progress payments are not necessarily assessable when received. Where progress payments or advances are
received, they are assessable only to the extent to which they have been derived. The amount that is required
to be taken into account for income tax purposes is the amount that relates to work done up to balance date.

Example:
A contract was budgeted to take 120 hours and (as at balance date) only 30 hours had been completed (one-quarter complete).
The total fees anticipated from the contract are $6,000. The client had paid $3,000 at balance date. In such a case, only $1,500
would be assessable (ie one-quarter of $6,000).

In HW Coyle Ltd v Commissioner of Inland Revenue (1980) 4 NZTC 61,558, (1980) 4 TRNZ 1 (HC), the
taxpayer had prepared its accounts on the basis that only profits on completed building contracts were taken
into account, ie no profits on work in progress were included as income until the contracts were completed.
The question at issue was the correct method of bringing into the accounts the progress payments for work
which had been completed and for which the architects had certified payment. The High Court held:
(a) Where progress payments are received under a long-term contract, it depends on the terms of the
contract and the provisions for payment whether a profit has been derived at any particular stage;
(b) For income tax purposes, the progress payments received during any one year were income and not
capital. The surplus, after making the permitted deductions, was a profit or gain derived from a
business; and
(c) The CIR must calculate the income as being the total progress payments earned during the financial
year including payments for extras and final payments, plus interest earned and a proportion of the
establishment fee, less all items of expenditure actually incurred and deductible in the year, together
with any other authorised items of deduction such as depreciation.

Since this case, the unexpired portion of prepayments would also impact on net income [see 1140
PREPAYMENTS].

750.50 Supply of power
Electricity supplied by a power company but not metered or invoiced at balance date constitutes income
“derived” for tax purposes: Hawke’s Bay Power Distribution Ltd v Commissioner of Inland Revenue (1999)
19 NZTC 15,226 (CA). The reasons are as follows:
(a) The earning process is complete when the electricity is supplied to, and consumed by, consumers.
At that point, a legally enforceable right to the income from the “sale” arises;
(b) The electricity supplied and consumed is capable of reasonable estimation and is, in fact, quantifiable
at that point;
(c) The recognition of the income at this stage is supported by good accounting practice generally,
including the importance of matching the cost of supplying goods or services against revenue from
that supply; and
In the present case, the taxpayer had accrued unbilled sales of electricity for financial reporting purposes but not for tax purposes.

**750.55 Changing the method of returning income** [ss CH 4, DB 52, EG 2]

Where a taxpayer changes from a cash to an accrual basis of returning income (or vice versa) adjustments need to be made in the year of change.

Where the change is from cash accounting method to an accrual accounting method:

(a) Any amount owed to the person on the last day of the income year immediately preceding the year of change is income in the year of change; and

(b) Any amount owed by the person on the last day of the income year immediately preceding the year of change is an allowable deduction in the year of change.

Where the person is changing from an accrual accounting method to a cash accounting method:

(a) The sum of all amounts owing by the person in the year of change which have been allowed as a deduction in prior income years is to be included in income in the year of change; and

(b) The sum of all amounts owing to the person in the year of change which have been treated as income in prior income years is an allowable deduction in the year of change.
### Chapter 760

**Income from New Zealand and Foreign Sources**

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#### 760.10 Source of income and residence determines assessability [s BD 1]

The liability of a person for New Zealand income tax depends on the source of the income (where the income is derived from) and whether or not the person is a tax resident of New Zealand. In general, a person who is a New Zealand resident is liable for income tax on all the income they derive, whether that income is derived from New Zealand or from elsewhere, whereas a person who is not a New Zealand resident is liable for income tax only on income derived from New Zealand.

These principles are set down in s BD 1, which includes all income (as defined in Part C) of any person in the potential tax net, but then excludes from the net exempt income, excluded income and non-residents’ foreign-sourced income. The result is that residents are taxed on all assessable income, while non-residents are taxed only on assessable income derived from New Zealand.

In considering the taxation of cross-border income, it is also necessary to consider whether the terms of any double tax agreement may have an impact. For example, if a person is a tax resident of both countries that are parties to a double tax agreement, the rules set out in the agreement will be applied to determine which country the person is deemed to be resident in [see 310 DOUBLE TAX AGREEMENTS].

#### 760.15 Definition of New Zealand [s YA 1]

“New Zealand” is defined as the islands and territories within the realm of New Zealand, but does not include the Cook Islands, Niue, Tokelau or the Ross Dependency (Antarctica) [Interpretation Act 1999, s 29].

The definition of New Zealand for income tax purposes includes the continental shelf and the water and the air space above any part of the continental shelf that is beyond New Zealand’s territorial sea, if and to the extent to which:

(a) Any exploration or exploitation (including of natural resources), is or may be undertaken; and

(b) The exploration or exploitation involves any activity on, in, or in relation to the water or air space [s YA 1].
“Territorial sea” is defined in s 3 of the Territorial Sea, Contiguous Zone, and Exclusive Economic Zone Act 1977 (which is essentially the seabed and subsoil of the submarine areas extending beyond the territorial limits of New Zealand to the edge of the continental margin, or to a distance of 200 nautical miles, where the continental margin does not extend to that distance).

760.20 Income treated as having a New Zealand source [ss YD 4, YZ 1]

Persons not resident in New Zealand are not subject to income tax in New Zealand if the amount is a foreign-sourced amount. A foreign-sourced amount is an amount of income that is not treated as having a source in New Zealand under ss YD 4 and YZ 1 [s YA 1].

Thus, persons not resident in New Zealand will be subject to income tax in New Zealand when they are in receipt of income treated as having a source in New Zealand under s YD 4.

The following classes of income are treated as having a source in New Zealand:

(a) Income derived from a business that is wholly carried on in New Zealand;
(b) Income derived from a business that is partly carried on in New Zealand, to the extent the income is apportioned to a New Zealand source under s YD 5 (see below);
(c) Income derived from a contract that is:
   (i) Made in New Zealand, except to the extent to which the contract is wholly or partly performed outside New Zealand, and the income is apportioned to a source outside New Zealand under s YD 5 [see 760.25];
   (ii) Made outside New Zealand but the contract is wholly or partly performed in New Zealand, to the extent to which the income is apportioned to a New Zealand source under s YD 5;
(d) Employment income under s CE 1 [see 1300.10] earned in New Zealand, even if the employer is not a New Zealand resident;
(e) Accident compensation payments as defined in s CF 1(2) [see 20.60];
(f) Pensions or annuities payable by the New Zealand Government or out of a superannuation scheme established in New Zealand;
(g) Gratuitous payments made in return for services provided by a person or their relative [within the definition of “pension” in s CF 1(2)] if the services are provided in New Zealand;
(h) Income derived by a person as the owner of land in New Zealand;
(i) Income, other than a royalty, derived as consideration for the use of, or right to use, personal property in New Zealand if the income is paid by a New Zealand resident or by a non-resident (if the non-resident is allowed a deduction for the payment);
(j) Royalties that are paid by a New Zealand resident if they are not made in connection with a business they carry on outside New Zealand through a fixed establishment outside New Zealand;
(k) Royalties that are paid by a non-resident, if the non-resident is allowed a deduction for the payment;
(l) Income derived from shares in, or membership of, a company resident in New Zealand;
(m) Interest or a redemption payment derived from money lent in New Zealand;
(n) Interest or a redemption payment derived from money lent outside New Zealand:
   (i) To a New Zealand resident, unless the money is used for the purposes of a business they carry on outside New Zealand through a fixed establishment outside New Zealand;
   (ii) To a non-resident, if the money is used by them for the purposes of a business they carry on in New Zealand through a fixed establishment in New Zealand;
(o) Income from securities issued by the New Zealand Government;
(p) Income derived from debentures issued by a local authority or public authority;
(q) Income derived from a mortgage of land in New Zealand;
Income from New Zealand and Foreign Sources

(r) Income derived from the disposal of property situated in New Zealand;
(s) Income derived by a beneficiary from a trust to the extent to which the income of the trust fund has a source in New Zealand;
(t) Income derived from transporting people or property by air if the transportation leaves from New Zealand;
(u) Income derived from transporting people or property by sea if the transportation leaves from New Zealand, to the extent to which the income is apportioned to a New Zealand source under s YD 6 [see 760.30];
(v) Premiums for general insurance paid to a non-resident general insurer of the type described in s YD 8, to the extent set out in s YD 8(2) [see 800.75];
(w) Income of a non-resident life insurer calculated under s EY 48 [see 800.45];
(x) Income of a New Zealand partnership, if the income is treated as having a source in New Zealand under any other provision of s YD 4, with all the partners being treated as resident in New Zealand. A “New Zealand partnership” is defined as a partnership that:
   (i) Is a limited partnership; or
   (ii) Has 50 per cent or more of its partners’ interests (by value) in capital held by New Zealand residents; or
   (iii) Has its centre of management in New Zealand, ignoring s HG 2;
(y) Income derived directly or indirectly from any other source in New Zealand.

Paragraphs (m) and (n) apply to:
(a) Interest derived from money lent under a binding contract entered into on or after 29 July 1983; and
(b) A redemption payment made on a commercial bill if it was issued on or after 29 July 1983 and it was not issued under a binding contract entered into before that date [s YZ 1].

760.23 Apportionment of income [ss YD 5, YD 6]

(1) Derived partly in New Zealand [s YD 5]
An apportionment of income is required when any one or more of the following applies:
(a) A business is carried on partly in New Zealand and partly outside New Zealand;
(b) A contract is made in New Zealand and is performed, in whole or in part, by a person outside New Zealand; or
(c) A contract is made outside New Zealand and is performed, in whole or in part, by a person in New Zealand.

The amount of income derived from the business or contract, and the expenditure incurred in deriving that income, must be apportioned between New Zealand and overseas sources. The result of this apportionment, to the extent consistent with exclusions (a) and (b) below, must be that the person’s net income or net loss from the business or contract is the same as a separate and independent person would have if they were carrying out only the person’s New Zealand activities and dealing at arm’s length.

The apportionment rules in s YD 5 do not limit the effect of:
(a) Any of the source rules in s YD 4 [see 760.20] except for those in s YD 4(2) and (3), which relate to businesses carried on in New Zealand and contracts made or performed in New Zealand;
(b) The source rules in s YD 4(2) and (3) to the extent to which the income referred to is also income referred to in any source rule other than those in s YD 4(2) and (3).

(2) From sea transport [s YD 6]
When a non-resident derives income from transporting people or property by sea from New Zealand to a destination outside New Zealand, five per cent of the amount is treated as having a source in New Zealand.
and the remainder is treated as not having a source in New Zealand. For this purpose, the transport of people or property from a port in New Zealand is treated as transport to a place outside New Zealand even if the ship calls at another New Zealand port before leaving New Zealand.

The CIR may reduce the amount treated as having a source in New Zealand, to the extent to which the amount would be treated as exempt or not having a source in the country the person is resident in. The non-resident is denied a deduction under s DW 3 for expenditure or loss incurred in deriving the income.

760.25 **Income to be shown in New Zealand currency** [ss YF 1, YF 2]

All income derived by a New Zealand resident, wherever derived, is subject to income tax in New Zealand, and must be expressed in New Zealand currency.

Business income is often not quantified until after the end of the income year. In this case, the exchange rate used could be an average of the mid-month rates, or the rate applicable at balance date.

(1) **Currency conversion**

When an amount is paid or payable in a foreign currency and there is no specific rule prescribed for converting it into New Zealand currency, a number of alternative conversion methods are available. If none of the methods set out below applies, the amount must be converted using the close of trading spot exchange rate on the date the amount is required to be measured or calculated.

If the CIR allows it, or if there is a provision in the ITA that specifically allows it, the amount may be converted using the average of the close of trading spot exchange rates for the 15th day of each complete month that falls in the relevant period.

The amount may be converted using a rate set by the CIR, or a rate calculated using a method approved by the CIR, for general use.

A person may also convert the amount using a rate set by the CIR, or a rate calculated using a method approved by the CIR, specifically for that person’s circumstances [s YF 1].

If a provision in the ITA other than s YF 1 provides a rate or method for currency conversion, a person may, instead of using that rate or method, use a representative conversion rate set by the CIR [s YF 2].

(2) **Overseas investment income**

A taxpayer with overseas investment income should convert that income to New Zealand currency as follows:

(a) *Income remitted back to New Zealand as derived:* The gross amount (inclusive of any foreign tax) actually received in New Zealand currency is taken.

(b) *Income not remitted back to New Zealand:* Convert the income to New Zealand currency using the telegraphic transfer buying rate for the day the income was derived (ie paid or credited). Either the actual rate (obtainable from any trading bank) or the mid-month telegraphic buying rate (shown below) may be used.

Business income is often not quantified until after the end of the income year. In this case, the exchange rate used could be an average of the mid-month rates, or the rate applicable at balance date.

(3) **Exchange rates**

The following table shows the available mid-month exchange rates for converting common foreign currencies to New Zealand dollars.

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The rates for February and March 2012 were not available at the time of publication.

A list of exchange rates for other currencies and a currency converter are available on Inland Revenue’s website or in Brookers *Tax Rates Guide 9-5000.*

**760.30 Allocation of income derived from countries with different income years [s EG 1]**

If a person derives foreign source income or incurs foreign expenditure, and the person’s income year in the country of source of the income differs from their New Zealand income year, the taxpayer may elect to return that foreign income and expenditure in the New Zealand income year in which the balance date applicable in the country of source of that foreign income falls.

**Example:**

A New Zealand person with a 31 March balance date derives business income from a country with a 30 June balance date. The taxpayer’s income and expenditure from that country for the year ended 30 June 20X1 would, on election, be included in the taxpayer’s return of income for the year ended 31 March 20X2. This is subject to the restrictions explained below.

The following definitions apply when making an election:

(a) “Foreign source income” means income that does not have a source in New Zealand and that is not exempt income.

(b) “Foreign expenditure” means expenditure that is incurred in deriving foreign source income.

The election is made by simply completing the tax return accordingly. An election will only apply to foreign source income and foreign expenditure which:

(a) Is taken into account in determining income tax payable in the foreign country, and has been included in the taxpayer’s income tax returns in that country; and

(b) But for the election would have been allocated to the taxpayer’s previous income year.

An election will not apply to income that is subject only to withholding tax in the foreign country.

A taxpayer cannot allocate foreign income and expenditure to an income year if that income and expenditure has already been included in the taxpayer’s return of income for the previous year. Once a taxpayer makes an election it continues to apply to all subsequent income years, unless Inland Revenue allows the taxpayer to revoke the election or unless the $100,000 limit, as explained below, is exceeded.

An election applies to all foreign source income and foreign expenditure except:

(a) Interest or income under the financial arrangements rules (unless Inland Revenue agrees);

(b) Dividends (unless Inland Revenue agrees and the taxpayer is not a company);

(c) Attributed controlled foreign company (CFC) income;
(d) Deductible foreign investment fund (FIF) income or income derived from an attributing interest; and
(e) Foreign expenditure relating to (a) to (d).

In deciding whether to consent to an election in relation to interest or dividends, Inland Revenue will take into consideration the taxpayer’s compliance costs, the risk to the revenue if the election applies, and any other relevant factors.

The rule in s EG 1 is principally a compliance cost mechanism that allows people with foreign income below a threshold to avoid the need to apportion the income and expenses to the correct equivalent New Zealand income year. The threshold for these purposes is $100,000 income from foreign sources. Thus, an election will not apply in any year in which net income from foreign sources exceeds $100,000. In these circumstances, or if the taxpayer does not make an election, an apportionment must be made [see TIB vol 6:12 (May 1995)].

**Example:**
If a person with a 31 March balance date derives rental income from a foreign country that has a 30 June year end, the foreign income and expenses for the year ended 30 June 20X1 will be returned in the person’s return for the year ended 31 March 20X2. However, if this amount exceeds NZ$100,000, it will have to be apportioned so that the income for the nine months to 31 March 20X1 is included in the 20X0-X1 income year and the income for the three months to 30 June 20X1 is included in the 20X1-X2 income year.

760.35 Foreign income derived by New Zealand resident

A New Zealand resident [see 1250 RESIDENCE] is assessable on all foreign income [s BD 1], subject to specific exemptions. Credit is given under s LJ 2 for foreign tax actually paid, so far as it does not exceed the New Zealand income tax applicable to the foreign income, and as long as it is substantially of the same nature as New Zealand income tax [see 760.40]. The foreign tax may be an income tax (whether imposed by a central, state, or local Government), or a non-resident withholding tax. Many countries with which New Zealand has a double tax agreement impose a withholding tax, which is the final liability in the foreign country. There is no provision for adjustments or variations of this rate.

In general expenses incurred in deriving foreign-sourced income are deductible. When expenses exceed the income the loss is deductible from other income, or carried forward, but in the latter case there is no credit allowed for the foreign tax, as the formula for determining the New Zealand tax attributable to that income takes the expenses into account [see 760.45]. If the income is exempt or not taxable because the person is in an overall loss position then it is likely that the CIR will take the view that there is no New Zealand tax payable on the income, even though it reduced losses.

A variety of special rules affect overseas investments by New Zealand residents [see 850 INTERNATIONAL TAX REGIME].

(1) Exemption for transitional residents

The foreign income of new migrants arriving in New Zealand (referred to as “transitional residents”) is exempt from income tax for the first 48 months of residence. The exemption also applies to returning New Zealanders who have not been resident for at least 10 years. The exemption, which does not apply to employment income and income from services, was introduced to remove a perceived barrier for skilled individuals to move to (or return) New Zealand [see 370.35].

760.40 Foreign tax credit rules [ss LJ 1, YA 2(5); TAA, s 225B]

New Zealand adheres to the general international tax principles of allowing the country of source of income to tax that income and the country of residence to give a credit in respect of that tax. Thus, a New Zealand resident who derives assessable income from a foreign country is allowed a credit against their New Zealand income tax liability for any foreign tax paid on that assessable income. This prevents the taxpayer from being taxed twice on the same income.

A credit is not allowed for income tax paid in a country listed in sch 27, to the extent the tax is paid on types of income listed in the schedule. There are currently no countries listed in sch 27. The schedule may be amended by the Governor-General by Order in Council [TAA, s 225B].
An amount that is deemed not to be income under s EX 59 (in relation to an attributing interest in a foreign investment fund) is treated as assessable income for the purposes of determining a person’s entitlement to a credit.

A dividend paid by a company resident in a country with which New Zealand has a double tax agreement is treated as being derived from a source in that country for the purposes of the double tax agreement if:

(a) The company is not resident in New Zealand; and
(b) The law of the other country imposes foreign tax.

The term “income tax” when used in relation to tax imposed by another country means a tax of substantially the same nature as income tax imposed under s BB 1. It includes a tax, imposed as a collection mechanism for the foreign tax, that is of substantially the same nature as provisional tax, PAYE, RWT or NRWT [s YA 2(5)].

**760.45 Amount of foreign tax credit** [ss LJ 2, LJ 3, LJ 4, LJ 5; TAA, s 165A]

A New Zealand resident who derives foreign-sourced assessable income has a tax credit for a tax year for an amount of foreign income tax paid on a segment of foreign-sourced income, calculated as shown below. The segment of foreign-sourced income is determined as if it were the net income of the person for the tax year.

The person’s credit must not be more than their notional income tax liability (see below). If a person who qualifies for a foreign tax credit is also liable to pay foreign income tax in the country from which the income was derived because they are a citizen or resident of, or are domiciled in, that country, the credit is limited to the amount of foreign income tax that would have been paid in the other country if the person were not treated as a citizen or resident of, or domiciled in, that country.

The amount of tax credit allowed to a multi-rate PIE and an investor in a multi-rate PIE is limited under subpart HM [see 1130 PORTFOLIO INVESTMENT ENTITIES].

For the purposes of subpart LJ, “foreign income tax” means an amount of income tax of a foreign country.

A “segment of foreign-sourced income” is an amount of assessable income derived from one foreign country that comes from one source or is of one nature.

**Example:**

Patsy, a New Zealand resident, derived interest income and dividend income from Australia during a tax year. The interest income and the dividend income are two separate segments of foreign-sourced income.

A person’s notional income tax liability is calculated as follows:

\[
(\text{net income} - \text{losses}) \times \text{tax rate}
\]

Where:

“Net income” is the person’s net income for the tax year;

“Losses” is the amount of tax loss (excluding any loss balance carried forward to the tax year) that the person must subtract from their net income. “Losses” must not exceed net income;

“Tax rate” is the basic rate of income tax set out in sch 1, Part A.

When a person has more than one source or type of foreign-sourced assessable income, the amount of New Zealand tax relating to each segment is calculated using the formula:

\[
\frac{(\text{segment} - \text{person’s deductions}) \times \text{notional liability}}{\text{person’s net income}}
\]

Where:

“Segment” is the amount of the segment of foreign-sourced income for the income year;

“Person’s deductions” is the amount of the person’s deductions for the tax year corresponding to the income year that is attributable to the segment of foreign-sourced income;

“Notional liability” is the person’s notional income tax liability as calculated under the above formula;

“Person’s net income” is the person’s net income for the tax year corresponding to the income year under s BD 4(1) to (3).
If the total amount of New Zealand tax for all segments of foreign-sourced income is more than the notional income tax liability, the amount of tax for each segment is adjusted by multiplying it by the following ratio:

\[
\frac{\text{Person’s notional income tax liability}}{\text{NZ tax}}
\]

Where:

“NZ tax” is the total of the tax calculated for each segment of assessable income from all sources, including income with a New Zealand source.

A tax credit under s LJ 2 must be applied for within four years after the end of the tax year in which the taxpayer is entitled to have the credit. The CIR may extend this four-year period by another period of up to two years. The taxpayer must provide the information necessary to determine the amount of the credit, when making application [TAA, s 78B].

If a person has been allowed a credit of tax in excess of the amount properly allowable under a tax law, the CIR may recover the excess from the person in the same manner as if the excess were income tax payable, subject to ss LA 3 to LA 5, LJ 7 and LK 4 [TAA, s 165A].

760.55 Use of foreign tax credits by beneficiaries [s LJ 6]

When a resident beneficiary derives a taxable distribution as a beneficiary of a trust, the beneficiary is not allowed a tax credit for any foreign income tax paid on the distribution unless the tax is similar to non-resident withholding tax. If the foreign tax paid meets this requirement, the person is allowed a tax credit equal to the amount calculated using the formula:

\[
\left(\frac{\text{person’s taxable distribution}}{\text{total distribution}}\right) \times \text{foreign tax paid}
\]

Where:

“Person’s taxable distribution” is the taxable distribution derived by the person in their capacity as a beneficiary of the trust, including the amount of tax;

“Total distribution” is the total distribution derived by the person in their capacity as a beneficiary of the trust, including the amount of tax;

“Foreign tax paid” is the amount of foreign tax paid.

The term “taxable distribution” is explained in 1420.95. If the amount of the tax credit changes after the taxpayer has applied for the credit under s 78B of the TAA, the taxpayer must provide the CIR with all relevant information [TAA, s 78C].

760.60 Foreign tax credits repaid [s LJ 7]

A person who receives a repayment or refund of foreign tax that has been claimed as a credit under s LJ 2 must pay the amount of the repayment to the CIR. This applies when the person receives:

(a) A refund or repayment of some or all of the foreign tax; or
(b) An amount or benefit, including the remission of a debt, determined directly or indirectly by reference to some or all of the amount of the foreign tax.

If the person has used a credit under s LK 1 relating to attributed CFC income, and the repaid tax relates to a CFC:

(a) The amount of the credit carried forward is extinguished to the extent of the reimbursement; and
(b) The person is liable to pay the CIR any repaid foreign tax remaining after the action in (a).

The due date for paying these amounts is 30 days after the later of:

(a) The date of the notice of assessment in relation to which the person has used the credit; or
(b) The date on which the person or another person who paid the tax (or a person associated with them) receives the refund.
**760.65 Evidence of foreign tax paid**

Where New Zealand has a double tax agreement containing a dividend article, and the other country imposes a tax on the dividend, Inland Revenue will accept claims for foreign tax credits on dividends without documentary evidence.

New Zealand’s double tax agreements generally limit the tax on dividends to 15 per cent. If a taxpayer wanted to claim a credit in excess of the tax rate applicable in the relevant DTA, the CIR will generally not allow the excess as the country of source of the income has charged tax in excess of the rate provided, and in this case the taxpayer’s best recourse may be to approach the tax authorities of the jurisdiction of source of the income and request a refund.

For other forms of foreign-sourced income, evidence of the amount of foreign tax paid must be provided before a tax credit is allowed. Where the foreign tax paid is less than $500, Inland Revenue will accept a chartered accountant’s certificate stating that documentary evidence has been sighted and that the tax claimed has not been subsequently refunded [see Inland Revenue *Technical Rulings Manual*, para 45.5.5 or PIB 90 (May 1997)].

**760.70 Interest from Australian companies and from Commonwealth Bonds**

A 10 per cent withholding tax is deducted by Australian companies from interest payable to non-residents. The withholding tax is a final tax in Australia. The interest is included in the New Zealand assessment of a New Zealand resident and credit allowed for the 10 per cent withholding tax up to the amount of the New Zealand tax on the interest. Commonwealth Bond interest is not subject to the withholding tax deduction, so no credit is allowable in New Zealand for Commonwealth Bond interest.

**760.75 Dividends from Australian companies**

Under the imputation system operating in Australia, dividends paid by Australian companies that have paid sufficient company tax carry franking credits and are known as franked dividends. Dividends paid by Australian companies that have not paid Australian company tax do not carry franking credits and are known as unfranked dividends. Australian residents are required to include the franking credits in their income, and are allowed a tax rebate up to the amount of the franking credits. New Zealand residents are not entitled to receive a refund of the franking credits from the Australian tax authorities. Fully-franked dividends are not subject to Australian non-resident withholding tax while unfranked dividends continue to be subject to Australian non-resident withholding tax.

As New Zealand residents are not entitled to the benefit of any franking credits they are not included in the amount of the dividends which are subject to tax in New Zealand. The franking credits would not qualify as a credit to be allowed against income tax payable in New Zealand as it is not income tax that the person was personally liable to pay [s YA 2(5)]. Therefore, New Zealand residents receiving franked dividends from Australia are taxed on the amount of the actual dividends paid by the Australian company, excluding the amount of any franking credits attached. As fully-franked dividends are not subject to Australian withholding tax, no credit is allowed for Australian tax in the New Zealand tax assessment (but see discussion below on Australian imputation credit account companies).

The gross amount of unfranked dividends received by New Zealand residents should be included in the New Zealand tax assessment with a credit being allowed for the lesser of:

(a) The Australian 15 per cent withholding tax paid; or
(b) The New Zealand tax payable on the Australian dividends.

A New Zealand shareholder may receive a dividend from an Australian company which is partly franked.

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**Example:**

A New Zealand shareholder in an Australian company receives the following dividend statement:

| Franked amount | $100.00 |

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### Income from New Zealand and Foreign Sources

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unfranked amount</td>
<td>$80.00</td>
</tr>
<tr>
<td>Withholding tax</td>
<td>$12.00</td>
</tr>
<tr>
<td>Franking credit</td>
<td>$63.93</td>
</tr>
</tbody>
</table>

The amount that is taxable in New Zealand is $180. The amount that the taxpayer would have actually received from the Australia company is $168 ($100 + $80 − $12). The withholding tax credit of $12 is allowed as a foreign tax credit under s LC 1 [see TIB vol 4:1 (August 1992) at 10].

(1) **Australian imputation credit account companies**

Australian resident companies can elect to maintain an imputation credit account (ICA) in New Zealand and can distribute dividends with either or both imputation credits and franking credits attached [see 670.405, 670.410]. This would be of benefit to an Australian company carrying on business in New Zealand (eg through a branch) and paying New Zealand income tax on its New Zealand sourced income. Income tax paid in New Zealand would be credited to the company’s ICA. If the company has New Zealand resident shareholders, those shareholders can then take advantage of the imputation credits attached to a dividend. Australian resident shareholders of the company cannot, however, use the imputation credits.

The reverse also applies — New Zealand resident companies can elect under Australian tax law to be New Zealand franking companies and attach franking credits as well as imputation credits to their dividends. The franking credits can be used by Australian resident shareholders, but not by New Zealand residents.

### 760.80 Netherlands social security pensions

Netherlands social security pensions paid to New Zealand residents are taxed as follows:

(a) If the New Zealand tax resident who receives the pension is also a New Zealand citizen, the pension is taxable only in New Zealand.

(b) If the New Zealand tax resident who receives the pension is not a New Zealand citizen, the pension may be subject to tax in both the Netherlands and New Zealand. In this case, a credit of tax will be available in New Zealand for tax paid in the Netherlands [see 760.40, 760.45].

This treatment was confirmed in public ruling BR Pub 07/10, which applies from 1 December 2006. The ruling is based on art 19(2) of the double tax agreement between New Zealand and the Netherlands [see 310.130], which states that a social security pension may be taxed by the country from which it is paid, but the pension will be taxed only in the country in which the recipient is resident if the resident is also a national (citizen) of the country of residence. New Zealand does not have an exclusive right to tax the pension if the recipient is a New Zealand resident but not a citizen of New Zealand [see TIB vol 20:1 (February 2008) at 3].
Chapter 770
Income Year and Balance Date

770.10 Income year and tax year [s YA 1]
The “tax year” is the period starting on 1 April and ending on 31 March.
The “income year” is:
(a) The period (usually a year) ending on a date other than 31 March, for a person with an approved non-standard balance date [under s 38 of the TAA]; or
(b) The period starting on 1 April and ending on 31 March, for any other person.

Under s 38 of the TAA a taxpayer may elect to file a return for the year ending with the date of the annual balance date of the person’s accounts. Where a person elects to file a return that aligns with the annual balance date of the person’s accounts, the income year is the period ending on the annual balance date. In the year in which a person’s balance date changes, the income year will be a period of less than a full year.

770.20 Balance dates, accounting years, and income years [s YE 1; TAA, s 38]
Unless the context otherwise requires, references to persons with a standard balance date, or a standard accounting year, or a standard income year are references to those persons who furnish a return of income under s 33 of the TAA for a tax year ending on 31 March — being the tax year in respect of which the reference is made.

A reference to a tax year that is identified by a reference, in full or short form, to two successive years is a reference to a tax year that starts on 1 April of the earlier tax year and ends on 31 March in the later year. For example, “20X1-20X2 tax year” and “20X1-X2 tax year” are both references to the tax year ended 31 March 20X2.

A taxpayer may, with the consent of the CIR, 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. Any election made by the taxpayer is to continue in force unless and until it is altered by the taxpayer with the prior approval in writing of the
CIR. A multi-rate PIE that does not calculate and pay tax using the provisional tax calculation option under s 44 must not make an election to adopt a non-standard balance date [TAA, s 38].

“Corresponding income year” is defined in s YA 1 as an income year that ends in the period starting on 1 October in the tax year and ending on 30 September immediately after the tax year. This concept aligns the “tax year” with a non-standard income year. References in the ITA 2007 to an income year are aligned with the corresponding tax year under this rule.

Example:
The corresponding tax year for a person with an income year ending on 30 June 20X2, is the tax year ending 31 March 20X2, as 30 June 20X2 is a date ending in the period starting after 1 October 20X1 and ending before 30 September 20X2. An income year ending 31 December 20X2 corresponds with the tax year ending 31 March 20X3.

A person to whom s 33A of the TAA applies (i.e., individuals not required to furnish returns and who will not receive income statements from the CIR), is unable to adopt a non-standard balance date [see 1270.70].

(1) **Non-standard balance dates**

A reference to a person with a non-standard balance date, or a non-standard accounting year, or a non-standard income year is a reference to a person who furnishes a return of income under s 38 of the TAA for a tax year on the basis of a corresponding income year ending on a date other than 31 March. Unless the context requires otherwise, the non-standard year is the accounting year that corresponds to the tax year for which the reference is made.

(2) **Early balance dates**

A reference to a person with an early balance date is a reference to a person who has approval under s 38 of the TAA to file a return of income for a tax year on the basis of a corresponding income year that ends between 1 October and the following 31 March, both days inclusive. Unless the context requires otherwise, the year with the early balance date is the accounting year that corresponds with the tax year for which the reference is made.

Example:
A balance date of 31 December, when approved by the CIR under s 38 of the TAA, is an early balance date, because it falls between 1 October and the following 31 March. The income year ended 31 December 20X1 corresponds with the tax year ended 31 March 20X2.

(3) **Late balance dates**

A reference to a person with a late balance date is a reference to a person who has approval under s 38 of the TAA to file a return of income for a tax year on the basis of a corresponding income year that ends between 1 April and the following 30 September, both days inclusive. Unless the context requires otherwise, the year with the late balance date is the accounting year that corresponds with the tax year for which the reference is made.

Example:
A balance date of 31 May, when approved by the CIR under s 38 of the TAA, is a late balance date, because it falls between 1 April and the following 30 September. The income year ended 31 May 20X1 corresponds with the tax year ended 31 March 20X1.

770.40 **Trustees with non-standard income year** [s HC 6(3), (4)]

When a trustee has a non-standard income year (i.e., an approved balance date other than 31 March) and an amount derived by the trustee in the income year is also beneficiary income, the beneficiary is treated as having derived the income in the same tax year as that corresponding to the trustee’s income year [s HC 6(3), (4)].

Beneficiary income includes not only income that vests absolutely in interest in a beneficiary in the income year, but also income that is paid to the beneficiary in the income year or by the later of the following dates:

(a) A date that falls within six months of the end of the income year; or
770.50 Income Year and Balance Date

(b) The earlier of:
   (i) The date on which the trustee files the return of income for the income year; or
   (ii) The date by which the trustee must file a return for the income year under s 37 of the TAA [s HC 6(1), (1B)].

Example:
A trustee has an approved 30 June balance date. For the 20X1 income year, beneficiary income includes any trust income paid to the beneficiary between 1 July and 31 December 20X1 (or later, if the trustee filed the return of income after 31 December 20X1). From the beneficiary’s perspective, this income will be treated as having been derived in the tax year ended 31 March 20X1 (because this is the tax year that corresponds with the trustee’s income year).

770.50 Election to change balance date [TAA, s 38]

A taxpayer may, with the CIR’s consent, elect to adopt a non-standard balance date for income tax purposes [see 770.20].

Standard practice statement SPS 08/04 [see TIB vol 20:11 (February 2009) at 9-17], which applies from 1 January 2009, sets out Inland Revenue’s practice for considering applications for the CIR’s approval for a change in balance date and replaces all previous Inland Revenue policy statements on this topic. Only taxpayers with an obligation to file returns under s 33 of the TAA (generally persons in business and those who receive income not taxed at source) may apply for a non-standard balance date. Portfolio tax rate entities that do not make payments under s HL 23 [since repealed] cannot elect to adopt a non-standard balance date. An approved non-standard balance date must be the last day of a month.

There is no right to challenge a decision by the CIR under s 38 of the TAA. Taxpayers who disagree with a decision can discuss it with Inland Revenue or seek a judicial review.

(1) Acceptable reasons for a change of balance date
The CIR will agree to a change in balance date in the following circumstances:

<table>
<thead>
<tr>
<th>Reason for change</th>
<th>Mode of election</th>
</tr>
</thead>
<tbody>
<tr>
<td>A business taxpayer elects to change a balance date and can present good business reasons as to why a 31 March balance date is impractical for returning income, or their circumstances have changed significantly and they should be permitted to further change a non-standard balance date previously consented to. This will include a consideration by the CIR of elections by new business taxpayers to adopt a non-standard balance date from their first tax year.</td>
<td>Long form</td>
</tr>
<tr>
<td>A business taxpayer elects to adopt a recognised industry balance date [see 770.55].</td>
<td>Short form</td>
</tr>
<tr>
<td>A franchise owner is required, as a condition of a franchise agreement, to use a non-standard balance date for financial reporting purposes and the applicable balance date has been recognised by agreement between the CIR and the master franchisor.</td>
<td>Short form</td>
</tr>
<tr>
<td>A shareholder-employee elects to adopt the same non-standard balance date as the company to which the shareholding relates and from which they derive their primary source of income.</td>
<td>Short form</td>
</tr>
<tr>
<td>A continuing estate wants to adopt a balance date that coincides with a deceased taxpayer’s date of death.</td>
<td>Short form</td>
</tr>
<tr>
<td>A subsidiary company elects to adopt the same non-standard balance date as used by the parent company.</td>
<td>Short form</td>
</tr>
<tr>
<td>A non-resident taxpayer, operating a business activity in New Zealand that has a centre of management outside New Zealand, elects to use a balance date for preparing annual accounts and returning income in their country of residence.</td>
<td>Short form</td>
</tr>
</tbody>
</table>
**Reason for change**

A business entity, with a close trading relationship with another business entity with a shared accounting system or central administration structure, elects to adopt a common non-standard balance date.

A managed fund elects to adopt a balance date in common with a fund manager or trustee when it can be demonstrated that a parent-subsidiary like relationship exists between the parties [see 770.60].

An entity deemed to be agent of a non-resident insurer is required to file “as agent” returns under s HD 16 [see 770.60].

(2) **Short form election**

The election to change a balance date may be made by telephone (0800 377 774) or in writing. The following details must be provided:

(a) The full name of the taxpayer seeking the non-standard balance date;
(b) Tax file number, if already registered;
(c) Reasons for the election to change balance date;
(d) The name of the tax agent (if applicable).

(3) **Long form election**

The election to change a balance date must be made in writing. The following information, where relevant, must be provided:

(a) The full name of the taxpayer seeking the non-standard balance date;
(b) Tax file number, if already registered;
(c) Reasons for the election to change balance date;
(d) The name of the tax agent (if applicable);
(e) Details of cash flows;
(f) Details of stock patterns;
(g) Details of any significant business transactions that will impact on the taxpayer’s tax liability for the current financial year;
(h) Other evidence to show that financial information prepared to the proposed balance date will be more appropriate to the entity;
(i) Where a new business is seeking a non-standard balance date (other than a recognised industry balance date);
(j) Where businesses claim that they have a close trading relationship and share a common accounting system or central administration structure, evidence of this.

(4) **Unacceptable reasons for a change of balance date**

The CIR will not agree to a change of balance date where the basis for the application is one or more of the following:

(a) The elected non-standard balance date is the anniversary date of the commencement of the business;
(b) A reason for changing the balance date is tax deferral or tax avoidance, or to take advantage of a tax incentive or concession;
(c) An election is made in order to smooth the workflow of a manager, trustee or tax agent;
(d) An election is made for reasons of administrative convenience; or
(e) Functions have been contracted out to a third party (eg a specialist administration manager) and the taxpayer elects to adopt the manager’s balance date.
(5) **Passive income**
Taxpayers whose primary source of income is from passive investments (e.g., rent, interest or dividends) are normally required to return this income to 31 March. However, there are two exceptions to this:

(a) When a taxpayer derives passive income from the business activity of a related entity with a non-standard balance date [see Example below]; and
(b) When a taxpayer with an attributing interest in a FIF calculates their FIF income using the accounting profits method or branch equivalent method. Section EX 69 provides specific rules for change of FIF balance dates and also require the CIR’s consent before a new accounting year can be used.

**Example:**
A family trust leases a factory to a family trading partnership. The family trust passively derives its primary source of income from the related family trading partnership, which has a non-standard balance date. In this case, the CIR will consent to the family trust adopting a common non-standard balance date.

(6) **Salary and wage earners**
Where a taxpayer has income from salary or wages as well as business income, the CIR may agree to a non-standard balance date for the business income under the normal rules.

**Example:**
A taxpayer earns a salary as a teacher and also derives business income from operating a small orchard. The taxpayer wishes to adopt a 30 June balance date. The CIR would agree to the change of balance date because it is an industry approved balance date. In this situation, the taxpayer will return her business income to 30 June, but will continue to return the income from her salary to 31 March.

(7) **Retrospective elections**
Normally the CIR’s consent for a change in balance date is required before the start of a new income year (i.e., the election cannot apply retrospectively). However, late applications for a change of balance date will be accepted if they are made before the earlier of the return filing date under s 37(1) of the TAA for the current balance date and that for the proposed balance date. Consent will be granted where taxpayers can show that:

(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 incidental tax deferral as a consequence of the proposed balance date is insignificant when compared with their tax liability for the year under their current balance date.

(8) **New business taxpayers**
The CIR will consider elections from new business taxpayers to adopt a balance date other than 31 March from their first tax year. Previously tax exempt activities that become new business taxpayers continuing the same activity may (with the CIR’s consent) retain the use of a non-standard balance date already used for existing financial reporting purposes.

**770.55 Industry-specific non-standard balance dates**
The CIR recognises a number of industry-specific non-standard balance dates. These dates have been determined following representations to the CIR by the industries concerned. Taxpayers within these industries, or closely aligned to them, may elect to adopt these approved industry balance dates [see 770.50], subject to the CIR’s consent in writing under s 38 of the TAA.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Recognised balance dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apiarists</td>
<td>30 November or 31 December</td>
</tr>
<tr>
<td>Cattle farmers</td>
<td>31 May</td>
</tr>
</tbody>
</table>
Income Year and Balance Date

**Industry** | **Recognised balance dates**
--- | ---
Dairy farmers | 31 May, 30 June or 31 July (depending on regional variations within the dairy industry)
Education/childcare related services | 31 December
Fishing industries | 30 September
Horse breeders | 31 July
Kiwifruit | 31 January to 31 March
Meat processing and export | 31 August or 30 September
Orchardists, pip fruit | 31 March, 30 June or 31 December
Seed dressers | 30 November
Sheep farmers | 30 June
Tobacco growers | 31 July

Taxpayers aligned to an industry still have the option of applying for an alternative non-standard balance date if the industry balance date does not suit their circumstances [see SPS 08/04, TIB Vol 20:11 (February 2009) at 16].

Recognised balance dates for the kiwifruit industry were 31 March, 30 April, 31 May or 30 June prior to 21 December 2010 [see TIB vol 23:1 (February 2011), at 101].

**770.60 Managed funds and “as agent” returns for non-resident insurers**

Inland Revenue will consider elections for non-standard balance dates from the following entities:

(a) The trustee of a unit trust that wishes to align its balance date with that of its manager;
(b) The trustee of a group investment fund that wishes to align its balance date with that of its manager;
(c) The trustee of a superannuation fund that wishes to align its balance date with that of its trustee or, where the fund is administered by an employer for the benefit of its employees, the balance date of the employer; or
(d) A resident taxpayer required to file an “as agent” return that wishes to align the balance date of that return with the taxpayer’s own non-standard balance date.

These entities may adopt a non-standard balance date in the following circumstances.

<table>
<thead>
<tr>
<th>Reason for changing balance date</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>A unit trust [see 1450.10] wishes to align its balance date with that of its manager.</td>
<td>The manager is the entity with the responsibility for the management of 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 the day-to-day administration of the unit trust.</td>
</tr>
</tbody>
</table>

A group investment fund [see 620.10] 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. Consent will only be granted to align the fund’s balance date with that of the manager. As with unit trusts, the concession applies when the manager has retained the responsibility for the day-to-day administration of the trust and for preparing the trust’s accounts. When these functions have been contracted out to a third party, it is not appropriate to adopt the manager’s balance date. |

Staples Tax Guide 2012
Reason for changing balance date

A managed fund wishes to align its tax balance date for financial reporting purposes.

Comment

A managed fund (including unit trusts, group investment funds and superannuation funds) may choose to align its balance date with that used for financial reporting purposes if it can be demonstrated that the alignment of the balance dates helps reduce the managed fund’s tax risks. The purpose of this concession is to promote voluntary compliance and good tax practices. Inland Revenue will examine the reasons for the change in balance date on a case-by-case basis. This concession does not apply if:

(a) The reason for changing the balance date is to improve the managed fund’s administration of staff (eg spreading workload);
(b) The managed fund cannot provide evidence of what the tax risks are and how the change of balance date helps mitigate these risks;
(c) The managed fund can identify some of its tax risks but the change in balance date would not mitigate these risks.

An employer superannuation fund wishes to align its balance date with that of the employer.

Any other superannuation fund [see 1390.10] (eg a wholesale or retail fund) wishes to align its balance date with that of its trustee.

A taxpayer who is an agent of a non-resident insurer wishes to align the balance date of its “as agent” return [see 40.50] to its own non-standard balance date.

Consent will be given for the fund to align its balance date with that of its trustee, provided the trustee’s role has not been contracted out to a third party.

A taxpayer who insures with a non-resident insurer is required to return part of the premiums paid as income in a return known as an “as agent” return [s HD 16]. Taxpayers with an approved non-standard balance date for their own returns will be granted consent to align the balance dates of their “as agent” returns to this date.

The way in which the election should be made is explained in 770.50 [see SPS 08/04, TIB vol 20:11 (February 2009) at 12-13].

770.70 Converting to a new approved balance date [TAA, s 39]

Section 39 of the TAA applies to determine the transitional year when a person changes their balance date under s 38 of the TAA to the balance date of their annual accounts. If the change is to a new balance date that is earlier in the year than the original balance date, the taxpayer has a transitional year from the original balance date up to and including the new balance date in the next succeeding year.

If the change is to a new balance date that is later in the year than the original balance date, the taxpayer has a transitional year from the original balance date up to an including the new balance date in the same year.

If a change in balance date means that a person has two 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.

The CIR may make any assessment necessary for the purposes of giving effect to ss 38 and 39 of the TAA. This allows the CIR to make an assessment for a period of shorter or longer than 12 months, with any necessary adjustments to reflect this.

The taxable income for a period of greater or less than a year must be adjusted for the purposes of determining the applicable tax rate, using the following formula:
Income Year and Balance Date

770.75

\[
\frac{365 \times \text{taxable income}}{\text{income year days}}
\]

Where:

“Income year days” is the total days in the income year or years that correspond to the tax year;

“Taxable income” is the person’s taxable income for the tax year.

The examples in 770.80 and 770.85 illustrate the adjustments needed when converting to a new approved balance date. The adjustments arise because the taxpayer is assessed for a period greater or less than a year, and certain tax credits are proportionately increased or decreased as the case may be [see TIB vol 7:13 (May 1996) at 15-19].

**770.75 Tax credits adjusted when change in balance date [s LC 10]**

When a taxpayer has had an approved change of balance date and as a result provides a return of income for a period of more or less than a year, the tax credits available to the taxpayer under ss LC 3 to LC 6 are increased or decreased proportionately using the following formula:

\[
\frac{\text{person’s total credits} \times \text{days}}{365}
\]

Where:

“Person’s total credits” is the total of the person’s tax credits under ss LC 3 to LC 6;

“Days” is the number of days in the period in relation to which the person provides the return.

The tax credits available under ss LC 3 to LC 6 are the school child tax credit, the transitional tax allowance, and the housekeeper or child care tax credit [see 1395 TAX CREDITS]. Since only persons in business qualify for a non-standard balance date under s 38 of the TAA, it is unlikely that they will qualify for the school child tax credit or the transitional tax allowance. The adjustment under s LC 10 is therefore only likely to apply to the housekeeper or child care tax credit.

**770.80 Change to an earlier balance date [TAA, s 39]**

When the new balance date referred to in 770.75 is an earlier date than the original balance date, the transitional year is for the period from the original date up to the new date in the next succeeding year. For example, in the case of an individual taxpayer changing from a 30 June balance date to a 31 March balance date, a return for the nine-month period intervening between the two dates must be furnished. Income tax will be assessed on the income derived during the nine-month period at the rate for 12 months. The calculations are on a daily basis.

**Example:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income for 274 days (1 July to 31 March)</td>
<td>$18,000.00</td>
</tr>
<tr>
<td>Gross up to 365 days</td>
<td></td>
</tr>
<tr>
<td>$18,000 × (365 / 274)</td>
<td>$23,978.00</td>
</tr>
<tr>
<td>Tax on $23,978 (at 2011-2012 tax rates)</td>
<td>$3,216.15</td>
</tr>
<tr>
<td>Therefore, tax on $18,000 at rate for $23,978</td>
<td></td>
</tr>
<tr>
<td>($18,000 / $23,978) × $3,216.15</td>
<td>$2,414.33</td>
</tr>
</tbody>
</table>

**770.85 Change to a later balance date [TAA, s 39]**

When the new balance date referred to in 770.75 is a later date than the original balance date, the taxpayer is required to furnish a return for a transitional year for the period from the original date up to the new date in the same year. For example, when a change of balance date is approved from 31 March to 30 June, the transitional period is from 1 April to 30 June. Technically, two returns of income are required to be furnished, one for the period ended 31 March and the other for the transitional income year 1 April to 30 June.
However, s 39(3) of the TAA now authorises a 15 month return by permitting the figures for both income years to be aggregated when the taxpayer’s net income or loss is determined. The following calculations are on a daily basis.

**Example:**
Income for 456 days (1 April to 30 June of following year) $20,000.00
Gross down to 365 days
$20,000 × (365 / 456) $16,008.00
Tax on $16,008 (at 2011-2012 tax rates) $1,821.40
Therefore, tax on $20,000 at rate for $16,008
($20,000 / $16,008) × $1,821.40 $2,275.61

**770.90 Share in partnership or estate return for more or less than 12 months**

In cases where the personal return is for a period of more or less than 12 months while the share of an estate or partnership is for a period of 12 months, the tax credits (if any) are increased or reduced by reference only to the period covered by the personal return. The rate of tax will also be calculated only by reference to the period covered by the personal return.

**Example:**
A personal return covers a period of eight months, and the partnership return covers a period of 12 months. The taxable balance is found by adding the two incomes. The rate of tax payable on that taxable balance is determined by increasing the personal income proportionately to bring it to 12 months, adding the partnership income, and finding the rate of tax payable on the resulting balance.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal return for eight months</td>
<td>$8,000</td>
</tr>
<tr>
<td>Plus share partnership income for 12 months</td>
<td>$960</td>
</tr>
<tr>
<td>Total income</td>
<td>$8,960</td>
</tr>
<tr>
<td>Provisional tax paid</td>
<td>$225</td>
</tr>
<tr>
<td>Rate ascertained as follows:</td>
<td></td>
</tr>
<tr>
<td>Eight months’ income</td>
<td>$8,000</td>
</tr>
<tr>
<td>Add four months to bring to 12 months</td>
<td>$4,000</td>
</tr>
<tr>
<td>Plus partnership income</td>
<td>$960</td>
</tr>
<tr>
<td>Total</td>
<td>$12,960</td>
</tr>
<tr>
<td>Income tax on $12,960 (at 2011-2012 tax rates)</td>
<td>$1,360.80</td>
</tr>
<tr>
<td>Income tax on $8,960 at effective rate for $12,960:</td>
<td></td>
</tr>
<tr>
<td>($8,960 / $12,960) × $1,360.80</td>
<td>$940.80</td>
</tr>
<tr>
<td>Credit for provisional tax</td>
<td>$225.00</td>
</tr>
<tr>
<td>Tax payable</td>
<td>$715.80</td>
</tr>
</tbody>
</table>

When a personal return covers a period of 12 months, and the partnership return is for a period of more or less than 12 months, the tax credits and rate of tax are calculated in the ordinary manner, with no adjustment by reason of the fact that the partnership return is for an odd period.

The foregoing is the general practice. However, where the income of the taxpayer concerned is substantially all from an estate or partnership, the CIR will consider assessing on the basis of the period covered in the return for the estate or partnership.

**770.95 Partnership balance date differs from personal balance date**

When a partnership balances its accounts on a date other than 31 March, the income derived in the accounting year is deemed to be derived to the nearest 31 March (tax year). This applies irrespective of the balance dates
adopted by the individual partners for income other than from the partnership. It means that irrespective of
the balance dates adopted by the partners for other income, or by the partners for the partnership income, the
normal rules apply in determining the year in which the income is assessable.

**Example:**

In each of the following cases the share of the partnership income for the year ended 30 September 20X2 (which corresponds
to the year ending 31 March 20X2), will be returned as income derived during the individual partners’ accounting year
assuming with the income year ended:

(a) Partner “A” returns it with other income for year ended 31 October 20X1;
(b) Partner “B” returns it with other income for year ended 30 June 20X2; and
(c) Partner “C” returns it with other income for year ended 31 March 20X2.

In *TRA Case K27* (1988) 10 NZTC 251, a partnership with a 31 March balance date was dissolved on 31 May
1983 when a new partnership was created. A balance date of 31 May was approved for the new partnership.
Partnership returns were filed for the 14-month period from 1 April 1982 to 31 May 1983, which allocated
the individual partners’ shares of income on the basis of twelve-fourteenths to the income year ended
31 March 1983 and the balance to the income year ended 31 March 1984. The CIR’s reassessment of partner’s
income, whereby the partner’s shares of income for the full 14-month period were included in the income
year ended 31 March 1984, was upheld.

### Different overseas income years [s EG 1]

If a person derives foreign source income, and the person’s income year in the country of source of the income
differs from their New Zealand income year, the taxpayer may elect to return that foreign income and any
associated expenditure in the New Zealand income year in which the balance date applicable in the country
of source of that foreign income falls [see 760.30].

### Standard balance date for salary and wage earners

In the case of taxpayers whose sole or principal source of income is derived from salary or wages, returns of
income must be furnished to 31 March in each year. The CIR has no power in such circumstances to accept
a return to a date other than 31 March.

Provisional taxpayers who derive salary and wages must return the salary or wages to 31 March even though
they have a different balance date. The tax paid at source on the salary or wages should also be returned to
31 March in these cases.

### Only business income returned to non-standard balance date

[TAA, s 38]

Only those taxpayers that can demonstrate a need to furnish a return of income to the annual balance of the
taxpayer’s accounts may apply to furnish a return of income for a corresponding income year that is different
from 31 March. Thus, a non-standard balance date is likely to be granted only to taxpayers with business
income. Income that is not derived from a business (eg salary, wages) must be returned to 31 March.

In *TRA Case K41* (1988) 10 NZTC 348 the taxpayer operated a business that was given approval to have a
balance date of 1 October. The taxpayer in that case furnished a return to that date, and in so doing, returned
six months of his salary and a full 12 months PAYE deductions to the next 31 March. The taxpayer in that
case argued that s 38 of the TAA authorised a complete change of the income earning cycle, from 31 March
to 1 October. However, the TRA did not accept that position, finding instead that the balance date change
applied only for the income from the business, and not for the salary and wages. The TRA then stated that
what s 33 of the TAA requires is that a return or returns be furnished setting forth a complete statement
of taxable income. Thus, a taxpayer may file a number of returns, all with different balance dates. What
mattered was that the statement of taxable income included income from all sources, irrespective of their
respective balance dates.

**Note:** Section 33 of the TAA has been changed over the years and now only refers to “a return” and has
dropped the requirement for a taxpayer to set forth “a complete statement of taxable income.” However,
despite these changes, the scheme of the TAA makes it clear that a return of income for a tax year will include income derived from all sources with corresponding income years.

**Example 1:**
An individual taxpayer derives income from part-time employment and from a business. The taxpayer has an approved non-standard balance date of 31 May. Income from the business derived during the 12 months ended on 31 May will be included in the taxpayer’s return for the tax year ending on the previous 31 March. However, the taxpayer must include wages received during the year ended on 31 March (not 31 May) in his return.

The CIR is of the opinion that the decision in *TRA Case K41* applies to all taxpayers with non-standard balance dates. Thus, for example, a trust with a non-standard balance date, which receives both business and non-business income, must return the business income to that non-standard balance date but the non-business income must be returned to 31 March. For a taxpayer that is not an individual (such as a company), all income will normally be business income. Business income includes all income associated with the taxpayer’s business, including any interest or dividend income related to those business activities (eg interest on a business bank account). Business interest and dividends will need to be apportioned to the relevant non-standard income years. However, RWT credits may not be apportioned and must be applied to the income year in which the deductions are made [see TIB vol 4:6 (January 1993) at 10-11].

**Example 2:**
Rob is in paid employment and also has a part-time business. The business has an approved non-standard balance date of 31 October. Rob will return his income from employment and interest from personal bank accounts each 31 March. He will return the business income, including interest from any business bank accounts, to each 31 October. Income returned to a 31 October balance date is required to be included in the return for the corresponding tax year ending 31 March. Rob will therefore make one return of income as at 31 March, which will include his business income to the non-standard balance date of 31 October. For his 31 October 20X1 balance date, Rob will return his business income as at 31 March 20X2. At that date he will also return his employment income and non-business interest derived to 31 March 20X2 [see TIB vol 4:6 (January 1993) at 10-11].
Chapter 780

Inland Revenue

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780.10 Inland Revenue Department [TAA, s 5]

Inland Revenue is the State department charged with the administration and collection of revenue under the various legislation.

780.15 Responsibility of Ministers and officials to protect integrity of tax system

Every Minister and every officer of any Government agency who has responsibility under any Act for the collection of taxes and other functions under the Inland Revenue Acts must use their best endeavours to protect the integrity of the tax system. Integrity of the tax system is defined to include (but is not limited to):

(a) Taxpayer perceptions of that integrity;
(b) The rights of taxpayers to have their liability determined fairly, impartially, and according to the law, and to have their affairs kept confidential and treated with no greater or lesser favour than those of other taxpayers;
(c) The responsibilities of taxpayers to comply with the law; and
(d) The responsibilities of those administering the law to do so fairly, impartially, and according to the law, and to maintain the confidentiality of the affairs of taxpayers [TAA, s 6].

“Government agency” includes any department or Crown entity, and any public authority [TAA, s 3]. The “Inland Revenue Acts” are those listed in the Schedule to the Tax Administration Act 1994:

(e) Child Support Act 1991;
(f) Estate and Gift Duties Act 1968;
(g) Estate Duty Abolition Act 1993;
(h) Estate Duty Repeal Act 1999;
(i) Gaming Duties Act 1971;
(j) Goods and Services Tax Act 1985;
(k) Income Tax Act 1994;
(l) Income Tax Act 2004;
(m) Income Tax Act 2007;
(n) KiwiSaver Act 2006;
(o) Land Tax Abolition Act 1990;
(p) Stamp and Cheque Duties Act 1971;
(q) Stamp Duty Abolition Act 1999;
(r) Student Loan Scheme Act 1992;
(s) Tax Administration Act 1994;

780.20 Commissioner of Inland Revenue and staff

The person appointed as the chief executive of Inland Revenue is designated as the Commissioner of Inland Revenue (CIR). The CIR is charged with the care and management of the taxes covered by the Inland Revenue Acts and with any other functions conferred on the CIR. It is the CIR’s duty, notwithstanding anything in the Inland Revenue Acts, to collect over time the highest net revenue that is practicable within the law, having regard to:

(a) Resources available to the CIR;
(b) The importance of promoting compliance, especially voluntary compliance, by all taxpayers; and
(c) Compliance costs incurred by taxpayers [TAA, s 6A].

The Governor-General may, by Order in Council, issue directions to the CIR about the administration of the Inland Revenue Acts. In doing so, the Governor-General must have regard to ss 6 and 6A of the TAA and the provisions of the State Sector Act 1988 and the Public Finance Act 1989. The Governor-General is not able to give directions concerning the tax affairs of individual taxpayers or the interpretation of tax law. Every order made under this provision must be published in the Gazette and laid before the House of Representatives together with any accompanying statement of the reasons for the order and any advice from the CIR about it. An order becomes binding on the CIR on the seventh day after the date on which it is made [TAA, s 6B].

The CIR is able to delegate any or all of his powers to any officer or officers of Inland Revenue. Such delegations must be in writing. When the CIR ceases to hold office, any delegations of power made by that person remain valid until a successor amends them [TAA, s 7].

Sections 8, 9, 10, and 11 of the TAA, which authorise the CIR to appoint deputy commissioners, regional controllers, district commissioners, and other officers, were repealed with effect from 10 April 1995. The provisions providing for the establishment of these positions are redundant following the enactment of the State Sector Act 1988.

780.21 CIR’s power to take securities [TAA, s 7A]

The CIR has the authority to accept securities to secure the performance of tax obligations by taxpayers. In so doing, the CIR is authorised to:

(a) Require that securities be given on such terms (including the manner of payment of any costs and disbursements associated with the security) as the CIR specifies;
(b) Require that securities be transferred into the name of, and be held by, the CIR until the performance of a tax obligation or obligations;
(c) Call for additional or substitute securities, if the CIR considers that the existing securities are or may be or may become inadequate or insufficient;
(d) Enforce a security if a taxpayer defaults in the performance of the tax obligation in respect of which the security was taken;
(e) Grant discharges, releases, or transfers of securities on terms the CIR considers appropriate; and
(f) Recover from a taxpayer the costs of accepting, enforcing, discharging, releasing, or transferring any security.

The CIR is not to be liable for any loss suffered in relation to an asset or right that is the subject of a security, unless the CIR is guilty of wilful misconduct in dealing with the asset or right.

The CIR and the CIR’s successors in office are deemed to be a corporation sole, and as such are to have and may exercise all the rights, powers, and privileges, and may incur all the liabilities and obligations, of a natural person of full age and capacity.
The following powers or rights are not limited by the powers relating to the taking of securities described above:

(a) Any tax law which specifies the CIR’s entitlement to a charge or other security;
(b) The CIR’s rights under the terms of a document evidencing or constituting a security; or
(c) The CIR’s other rights to collect or recover tax or other amounts.

The High Court case of Peterson v Commissioner of Inland Revenue (2005) 22 NZTC 19,482 (HC) confirmed the CIR’s ability to enforce a guarantee under s 7A of the TAA in any available manner. The case concerned a the director of a company who had given a personal guarantee to the CIR in an attempt to stave off liquidation of the company. When the company reneged on its arrangement with the CIR regarding the payment of tax arrears, the CIR called in the guarantee.

780.30 Activities and addresses of Inland Revenue offices

Tax returns and payments should be sent to one of the following processing centres.

<table>
<thead>
<tr>
<th>Returns and correspondence</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northern Processing Centre</td>
<td>PO Box 1454 PO Box 1535</td>
</tr>
<tr>
<td>Hamilton</td>
<td>Hamilton</td>
</tr>
<tr>
<td>Central Processing Centre</td>
<td>PO Box 39090 PO Box 39050</td>
</tr>
<tr>
<td>Wellington Mail Centre</td>
<td>Wellington Mail Centre</td>
</tr>
<tr>
<td>Southern Processing Centre</td>
<td>PO Box 3752 PO Box 3754</td>
</tr>
<tr>
<td>Christchurch</td>
<td>Christchurch</td>
</tr>
</tbody>
</table>

Companies whose annual turnover exceeds $100 million, companies whose industry is governed by specialised tax legislation, and large companies owned by non-residents are dealt with by the Corporates Segment.

Contact addresses for the corporate sector are as follows:

<table>
<thead>
<tr>
<th>Sector</th>
<th>Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking, Crown, Insurance, Resources</td>
<td>Private Bag 39984 Wellington</td>
</tr>
<tr>
<td>Computer tax audit, International audit, Non-resident contractors</td>
<td>PO Box 2198 Wellington</td>
</tr>
<tr>
<td>Manufacturing, Non-resident entertainers, Services</td>
<td>PO Box 5542 Auckland</td>
</tr>
</tbody>
</table>

All non-resident return forms (IR3NR) should be sent directly to:

Non-resident Centre
Inland Revenue
Private Bag 1932
Dunedin

Details of the structure of Inland Revenue and the functions of various business groups within it can be found in Brookers New Zealand Guide to Tax Audits (Brookers, Wellington, 1997), ch 2, “Inland Revenue Department Structure”.

780.40 Inland Revenue publications

Inland Revenue produces a range of publications for different types of users (the general public, tax agents, businesses, etc). The main categories of publications currently available are:

- Information booklets;
- Tax Information Bulletin (TIB);
- Regular newsletters for specific interest groups:
Business Tax Update

Agents’ Answers;

Large Enterprises Update.

[Note: GST News, FBT News and Payroll News were subsumed into the Business Tax Update in 2009; and Corporates Contact was replaced by the Large Enterprises Update in 2007.]

Information booklets are available on a wide range of topics, eg the GST Guide (IR375) and the Fringe Benefit Tax Guide (IR409). A complete list of the available booklets can be found in the back of the TIBs, on Inland Revenue’s website [see 780.50 for address] and Brokers Tax Service, an electronic database of tax information. Copies of booklets can be requested by phoning Inland Revenue. The booklets are also available in electronic form on the Inland Revenue website and in Brokers Tax Service.

The TIBs are available free of charge by completing the “Mailing list update form” in the back of any TIB and sending it to: TIB Mailing List, PO Box 31581, Lower Hutt. Alternatively, the TIBs (including all back copies) can be read or downloaded from the Inland Revenue website and Brokers Tax Service. TIBs can be viewed on the Inland Revenue website some time before the hard copy is distributed, and many items are posted on the site ahead of the monthly edition.

Determinations, rulings, and statements issued by Inland Revenue are published in the TIB and are also available in Brokers Tax Service. The various types of rulings are explained in 115 BINDING RULINGS.

The regular newsletters listed above are sent automatically to taxpayers whom Inland Revenue recognises as being in the interested group. For example, all employers registered for PAYE are automatically sent Business Tax Update. Other taxpayers can request these newsletters by contacting Inland Revenue. The newsletters are also available in electronic form on the Inland Revenue website and Brokers Tax Service.

The Public Information Bulletin (PIB), which preceded the TIB, was last published in July 1989 and much of its content is now obsolete or has been superseded. However, some parts of the PIB are still relevant to current tax practice. The PIBs are available in electronic form in Brokers Tax Service.

The Inland Revenue Technical Rulings Manual was previously available on request from Inland Revenue and has been republished in a number of electronic formats including Brokers Tax Service. In September 1998 Inland Revenue decided to cease updating the Technical Rulings Manual, except for the charitable donees list. According to Inland Revenue, the Technical Rulings Manual may, in some instances, be useful as background material, but the contents should not be relied on as representing Inland Revenue’s present views or practice [see TIB vol 10:9 (September 1998), at 10].

780.50 Inland Revenue website

Inland Revenue’s website www.ird.govt.nz contains information on a variety of topics including important dates, compliance and penalties information, Inland Revenue mission statement, frequently asked questions, publications, tax information for businesses, public rulings, child support, media releases, and TIBs.
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790.10 Tax audits
The objective of tax audits is to examine the returns of all business taxpayers in depth once within a five-year cycle, and to lower the emphasis on annual checking of returns [see PIB 82 (December 1982)]. Particularly in Inland Revenue’s Corporates unit, risk analysis techniques are used to identify risk areas for closer scrutiny.

Tax audits produce their own queries. These queries may be resolved by personal interviews with taxpayers and agents, rather than by correspondence. It assists both taxpayers and Inland Revenue if working papers used in preparing a return are on hand. One of the aims of the tax audit is to provide a more effective check for cases of evasion of tax.

Generally, tax audit inquiries are limited to the current year’s return, but if the inquiries prove unsatisfactory a full scale investigation is carried out. Errors of principle in the current year’s return do not necessarily mean that all earlier returns with similar errors are adjusted. Their significance is considered. The tax audit places more reliance on those who furnish returns.

A major benefit of tax audits to taxpayers or their agents is less time being spent on casual inquiries by correspondence and the settling of doubtful points by interview before formal inquiry is made.

Inland Revenue’s Taxpayer Audit unit is structured into segments to deal with particular segment groups. The segments are Business Direct, Business Link, and Corporates. Inland Revenue’s Corporates unit deals with businesses and groups with an annual turnover in excess of $100 million, Government departments, State-owned enterprises, local authorities and other specified industries.

The activities generally include:
(a) Checking for people outside the tax system who have not furnished returns, or people who omit untaxed income.
(b) Matching of employer tax deduction certificates and details of interest and dividends to taxpayer’s tax returns.
(c) A routine audit involving reviewing selected items from selected tax returns. Taxpayers or their agents may be asked for the source documentation to substantiate expenses claimed.
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(d) An extended audit involving a review of the full accounts from selected tax returns. This involves interviews with taxpayers, who are questioned about their “operating procedures” such as the recording of sales, disposal of assets, payments of expenditure etc, as well as specific items contained in the accounts and tax return. Where a taxpayer has an agent it also reviews the agent’s working papers and questionnaire. The agent is invited to attend the interview with the client.

(e) Technical checking mainly revolving around specialist tax areas (ie financial arrangements, uneconomic ventures, share trading, new legislation, etc). Interviews may not be conducted.

For a comprehensive coverage of tax audits, see Brooker’s New Zealand Guide to Tax Audits.

See also Inland Revenue Booklet Inland Revenue Audits Guide (IR297).

It is the CIR’s practice to resolve disputes arising from tax investigations by a process of negotiation with taxpayers or their advisers. To ensure that all taxpayers are treated uniformly, Inland Revenue has issued standard practice statement INV-350 Finalising agreements in tax investigations [see TIB vol 10:8 (August 1998)]. The statement, which applies to all Inland Revenue Acts and to all Inland Revenue staff who complete tax investigations, sets out the principles and parameters that Inland Revenue will apply when finalising agreements with taxpayers following tax investigations.

In addition, Inland Revenue has now adopted the practice of taping some interviews as a measure to streamline administrative practices. To complement this practice, Inland Revenue has issued standard practice statement SPS 10/01: Recording Inland Revenue interviews that outlines Inland Revenue’s standard practice when taping an interview. Key features of SPS 10/01 are that Inland Revenue will advise the interviewee of the intention to audiotape the interview before the time of the interview and that interviews will be carried out fairly as recordings may be admissible as evidence in subsequent legal proceedings. Generally, an electronic copy will be made available to the interviewee. Where a recording of an interview is taken, it generally will be an audio recording. However, in some cases, a video recording will be taken, [see TIB vol 22:7 (August 2010) at 51-53].

790.20 Power to inspect books and documents [TAA, s 16]

The CIR, or any officer of Inland Revenue authorised by the CIR, has full and free access at all times to all lands, buildings, and places, and to all documents, for the purpose of inspecting those documents and any property, process or matter which the CIR or officer considers necessary or relevant for the purpose of collecting tax or duty under any of the Inland Revenue Acts. This applies to all documents (including, for example, customer records held by a bank or client records held by a chartered accountant), whether they are in the custody or under the control of a public officer, a body corporate, or any other person. The CIR or officer may make extracts from or copies of the documents without fee or reward. The CIR or officer may also use such access if they consider it necessary to carry out any other function lawfully conferred on the CIR or to provide information otherwise required for the purposes of the Inland Revenue Acts.

“Document” is defined to include an item of information in any form held on any sort of device, the device itself and any device associated with it which is required for the expression of the information.

When needing to take a copy of information that is stored electronically, the CIR can take an image of the electronic storage media. The CIR has issued Standard Practice Statement SPS 10/02 setting out Inland Revenue’s practice when taking an image of a taxpayer’s electronic storage media. A relevance search will be carried out to determine whether the electronic storage medium contains “necessary or relevant” information or it is likely to provide any information otherwise required. In some cases, such as where the data is encrypted or where there has been a claim of legal privilege or non-disclosure right, the medium will be imaged without carrying out a relevance search. In the event that a claim of legal privilege or non-disclosure right for tax advice documents is made, the electronic storage medium will either be sealed, or imaged and then sealed, so that the information is preserved. Imaging of the electronic storage medium is generally performed on-site. However, the CIR may remove the storage medium for the purpose of imaging it. The Standard Practice Statement can be found in TIB vol 22:7 (August 2010) at 54-60.

The occupier of any land, building or place entered, or proposed to be entered, by the CIR or an authorised officer must provide the CIR or officer with all reasonable facilities and assistance for the effective exercise
of the powers under s 16 of the TAA and answer all proper questions relating to the effective exercise of powers under s 16 of the TAA orally or, if required by the CIR or officer, in writing or by statutory declaration. A person whom the CIR or an authorised officer considers necessary for the effective exercise of powers under s 16 of the TAA (ie an expert or specialist) may accompany the CIR or the authorised officer to a place.

Despite the general power of entry, the CIR, an authorised officer or an accompanying person must not enter a private dwelling unless the occupant gives their consent or entry is authorised by a warrant. A “private dwelling” is defined as any building or part of a building occupied as residential accommodation. This includes:

(a) Any garage, shed and other building used in connection with the dwelling; and
(b) Any business premises that are, or are within, a private dwelling.

A warrant authorising entry to a private dwelling must:

(a) Be in a form prescribed by regulations (see below);
(b) Specify an authorised Inland Revenue officer, by name or in general, who may act under the warrant;
(c) Specify whether other persons may accompany the officer acting under the warrant;
(d) Be valid for a period of one month from the date of issue or such lesser period as the judicial officer considers appropriate; and
(e) State its period of validity or the date on which it expires.

Anyone exercising the power of entry conferred by a warrant must produce the warrant and evidence of identity on first entering the private dwelling and whenever subsequently reasonably required to do so.

A judicial officer is any District Court Judge, Justice, Community Magistrate, or Registrar of District Court. A person who is an officer or employee of Inland Revenue may not issue a warrant.

The Tax Administration (Form of Warrant) Regulations 2003 prescribe the form of warrant to enter private dwellings, for warrants issued on or after 15 May 2003.

For examples see TES 42 (October 2006) 635.

790.25 Power to remove and copy documents [TAA, s 16B]

The CIR or an Inland Revenue officer authorised by the CIR has the power to remove any document accessed under s 16 of the TAA, for the purposes of making copies. The books or documents removed for copying must be returned as soon as practicable. This measure is intended to prevent taxpayers from destroying records which the CIR considers necessary to an investigation.

The power to remove under s 16B of the TAA is only for the purpose of making copies. Any use, inspection, or examination of documents, by Inland Revenue staff after removal must only be for the purpose of determining which items to copy. However, the CIR does have the power to remove and retain documents for the purpose of inspection under s 17(3) of the TAA.

The owner of any document that is removed by Inland Revenue is entitled to inspect, and obtain a copy of that document at the premises to which it is removed, at the time of removal or any reasonable time subsequently. This means that the person is able to accompany the officer (though not necessarily in the same vehicle), at the time of removal in order to enforce this right. Copies of books or documents made and certified by or on behalf of the CIR are admissible in evidence in Court as if it were an original.

The CIR or an Inland Revenue officer authorised by the CIR has the power to remove any document accessed under s 16 of the TAA and retain it for a full and complete inspection including for use as evidence in Court proceedings. In order to exercise this power, the CIR must have either the consent of the occupier or a warrant issued by a judicial officer. A judicial officer is a District Court Judge, Justice, Community Magistrate, or Registrar of District Court. Items taken under this provision may be retained for as long as necessary but the owner is entitled to a copy either at the time of removal or at a reasonable time subsequently. Any copy certified by the CIR is admissible as evidence in Court as if it were the original.
(1) Cases

In *Avowal Administrative Attorneys Ltd v North Shore District Court* [2008] 1 NZLR 675, (2007) 23 NZTC 21,616 (HC) and *Avowal Administrative Attorneys Ltd v North Shore District Court* (2007) 23 NZTC 21,610 (HC) the High Court considered the procedure to be followed by the CIR when removing books or documents for copying. Baragwanath J found that the CIR is required to inspect, but not examine in detail, any books or documents that are reasonably believed by the CIR to be necessary or relevant. This inspection is to be carried out before the books or documents are removed. This means that the CIR is not permitted to remove everything that he comes across irrespective of its relevance to his investigation. Instead he must conduct a preliminary inspection and remove only those books and documents that are likely to be relevant to his inquiries. In *Avowal Administrative Attorneys Ltd v North Shore District Court* (2009) 24 NZTC 23,252 (HC) Venning J dealt with the remaining issues arising in the judicial review. He found that:

(a) The hard drive of a computer is included in the definition of “books or documents” for the purposes of ss 16 and 16B of the TAA 1994.
(b) Inland Revenue has power under ss 16 and 16B to copy and remove, and authority to require access to, hard drives, subject to first undertaking a relevance search.
(c) It is not unlawful to remove and copy the hard drives without first undertaking a relevance search if the taxpayer has made a blanket privilege claim.
(d) It is also reasonable for Inland Revenue to take copies on site or if necessary to remove an encrypted hard drive without undertaking a relevance test, where that encryption renders a relevance search ineffective.

The taxpayer unsuccessfully appealed the High Court’s decision: *Avowal Administrative Attorneys Ltd v District Court at North Shore* [2010] NZCA 183. The Court of Appeal held that:

(a) The search or cloning of the hard drives without performing a key word search was reasonable, given that the taxpayer had made a blanket privilege claim.

   (i) The legality of a search under s 16 of the TAA depended on the reasonableness of the search in the circumstances because the power under the section is subject to, and must be exercised in conformity with, the reasonableness requirement found in s 21 of the New Zealand Bill of Rights Act 1990.

   (ii) Although a preliminary search is good practice, it is not a prerequisite to a reasonable search or to a reasonable access operation under s 16.

   (iii) An investigation made prior to a s 16 procedure may give the CIR sufficient information so that he can consider whether it is necessary to inspect and/or copy a hard drive without first performing a preliminary screening of the hard drive on the premises on which the hard drive is located.

   (iv) The broad power under s 16(1) of the TAA is necessary because of the complexity that can be found in tax investigations and is not analogous to the search and seizure power found in provisions such as s 198 of the Summary Proceedings Act 1957. Therefore cases that have ruled against unspecific search warrants are not directly on point in a case involving s 16(1) of the TAA.

(b) Section 16B(1) refers to books and documents to which the CIR has full and free access because that subsection provides for copying of “books or documents accessed” rather than “books or documents which may be inspected”.

   (i) Once a blanket privilege claim has been made it is open for the CIR to conclude that it is necessary to inspect the files after the blanket privilege claim is dealt with by the District Court under s 20(5) of the TAA. That section does not limit the CIR’s power to remove a document and place it in the custody of the District Court.
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(c) The Court of Appeal accepted the High Court’s findings that the CIR had intended to perform a key word search of the hard drives and that, given the CIR’s knowledge about the taxpayer and its activities, it was reasonable for the CIR to conclude that the hard drives were likely to provide information and needed to be inspected.

(d) The CIR was not required to seek the taxpayer’s assistance under s 16(2) of the TAA.

(e) On the evidence, the s 16 power had been used to obtain information that was necessary for or relevant to the investigation of activities that affected the tax liabilities.

(f) Computer hard drives come within the concept of “any other type of record whatsoever” in the definition of book and document in s 3 of the TAA.

The taxpayer sought leave to appeal the Court of Appeal decision to the Supreme Court. That application was declined as the taxpayer’s points did not have a sufficient legal basis and were in some respects inconsistent with factual findings made in the High Court and upheld in the Court of Appeal. There was no prospect of success: Avowal Administrative Attorneys Ltd v District Court at North Shore [2010] NZSC 104.

790.30 Information to be given to CIR on request [TAA, s 17]

The CIR has the power to require any person (including anyone employed by a Government Department, public authority, or other public officer), to provide any information in writing, and produce documents for inspection, if the CIR considers them necessary or relevant for any purpose relating to the administration or enforcement of:

(a) Any of the Inland Revenue Acts; or

(b) Any matter arising from or connected with any other function lawfully conferred on the CIR.

The CIR may:

(a) Require information in writing, or documents, to be produced at a particular office of Inland Revenue;

(b) Require that any written information or particulars provided be verified by statutory declaration or other means; or

(c) Make extracts from or copies of any documents produced for inspection, without fee or reward.

Information and documents that are in the knowledge, possession or control of a non-resident are treated as being in the knowledge, possession or control of a New Zealand resident, if the New Zealand resident directly or indirectly controls a non-resident. Any law in a foreign country that relates to secrecy of information law must be ignored.

In determining whether a non-resident is controlled by a New Zealand resident, anything held by a person who is resident in New Zealand, or is a CFC, and is associated with the New Zealand resident is treated as being held by the New Zealand resident.

The written information that may be required under s 17 of the TAA includes (but is not limited to), lists of shareholders of companies, with the amount of capital contributed by and dividends paid to each shareholder, copies of balance sheets and profit and loss accounts and other accounts, and statements of assets and liabilities. For examples see TES 42 (October 2006) at 636.

The CIR may remove and retain any documents produced for inspection for as long as is necessary for a full and complete inspection of them, including for use as evidence in Court proceedings. The owner of the documents retained by the CIR is, at reasonable times and subject to reasonable conditions set by the CIR, entitled to inspect those documents and obtain copies of them at their own expense.

The CIR’s power to require a person to furnish information and produce documents for inspection was considered in the following cases.

In Commissioner of Inland Revenue v Denby (1982) 6 NZTC 61,544 (DC), the taxpayers received a standard letter from Inland Revenue informing them a tax audit was going to be conducted and that certain business and private records would be examined. The taxpayers did not comply with the request and contended the CIR was not empowered to require information relating to non-assessable income and capital assets. Judge
Green held that the CIR may request this information if there was an indication that the taxpayer’s affairs were not all in order. In this case the CIR gave no reasons for the exercise of the discretion to require information which was considered “necessary and relevant”. Judge Green held that the discretion was exercised wrongly. Further, the Judge was not prepared, in the circumstances, to sever those parts of the notice which had been wrongly included and therefore the whole of each notice failed.

In *Schwass v Mackay* (1983) 6 NZTC 61,641 (HC), it was held that the District Court did not have the authority to review the CIR’s exercise of discretion as was done in the *Denby* case. Casey J held that the CIR is the sole judge of what is “necessary or relevant” and that unless the discretion was exercised improperly the Courts cannot review the decisions. This case upheld the decision of Judge Browne that a taxpayer must supply information, books, or documents requested even though they may assist to incriminate the taxpayer.

A notice to furnish information was issued and was followed by a second notice which covered documents referred to in the first notice as well as a number of further documents. This was followed by an amended assessment in which it was alleged that the taxpayer had an extra taxable income of $4.7 million. The High Court dismissed an application by the plaintiff taxpayer that the second notice and the amended assessment were invalid and unenforceable as the burden of proof as to the reality of the CIR’s thinking was upon the taxpayer, and it was an important function of the Court to ensure that the revenue officers were able to exercise their full powers. Although the application must be considered on the basis that allegations in the statement of claim can be proved, the criteria for striking out had not been met. At the heart of the application was the contention that the Inland Revenue action was triggered by an informer: *ER Squibb and Sons (New Zealand) Ltd v Commissioner of Inland Revenue (No 1)* (1991) 13 NZTC 8,096 (HC).

When the CIR issued notices seeking information in respect of the affairs of unnamed clients the Court of Appeal held that the CIR cannot be totally reliant on the taxpayer’s willingness to comply honestly and accurately with the reporting requirements of the legislation and often has regard to other information obtained from third parties. Inland Revenue may also require the provision of information in writing where no records are available and information sought is exclusively in the person’s mind. The power is amenable to judicial review which is conducted on a case-by-case basis: *Commissioner of Inland Revenue v New Zealand Stock Exchange* [1990] 3 NZLR 333 (CA). The case finally went to the Privy Council which held that it is not possible to insert any limitation as a matter of statutory construction: *New Zealand Stock Exchange v Commissioner of Inland Revenue* (1991) 13 NZTC 8,147 (PC). Limitation could only be inserted as a matter of policy by a process of judicial legislation on the grounds that Parliament could not have intended to confer a power so wide as not to be subject to such limitation. If the CIR had no power to obtain confidential information about taxpayers who may be negligent or dishonest, the whole rationale of taxation would break down and the whole burden of taxation would fall only on diligent and honest taxpayers. The Act imposes secrecy obligations on Inland Revenue. The search provisions cannot be said to be unreasonable, having regard to the secrecy provisions and to the fact that in the interests of the community the CIR is charged with ensuring that the income of every taxpayer is assessed and the tax is paid. The Court can only interfere if it is satisfied that in making a particular requirement the CIR exceeded or abused the powers available.

In *Russell v Latimer* (1990) 12 NZTC 7,321 (HC), it was held that the CIR was entitled to check whether taxpayers were fulfilling their tax obligations. The expenses incurred by the recipient of a search notice was not a basis for a review of Inland Revenue’s decision under the Judicature Amendment Act 1972. Inland Revenue is entitled to issue a notice and require it to be complied with notwithstanding that the information sought had already been complied with.

A taxpayer is not entitled to refuse to answer questions or provide information requested by the CIR under s 17 of the TAA on the grounds that the answers or information may lead to the taxpayer’s conviction. Such a refusal is a direct breach of s 17 of the TAA: *Singh v Commissioner of Inland Revenue* (1996) 17 NZTC 12,471 (HC).

A request by the CIR under s 17 of the TAA for the police to hand over books relating to a suspected drug dealer was not invalidated by the fact that the police had obtained the books during an unlawful search. The powers of the CIR under s 17 of the TAA override an application for the return of property under the Summary Proceedings Act 1957: *Wojcik v Police* (1996) 17 NZTC 12,646 (DC).
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R v Gilchrist (2006) 22 NZTC 20,043 (CA) was an appeal by the taxpayer to the Court of Appeal against his District Court conviction for knowingly not providing information to the CIR as required by a s 17 Notice, with the intention of evading the payment of tax. The Court of Appeal dismissed the appeal. The taxpayer’s further appeal to the Supreme Court was also dismissed was also unsuccessful: Gilchrist v R (2007) 23 NZTC 21,150 (SC).

790.32 Inland Revenue standard practice statement on s 17 notices

Standard practice statement SPS 05/08: Section 17 notices (with application from 22 June 2005) sets out the procedures Inland Revenue will follow when issuing s 17 notices and third party information request letters [see TIB vol 17:6 (August 2005) at 37-51]. The main points of the statement are as follows.

Generally, where information is publicly available (eg from the Land Transfer Office, Companies Office, or Quotable Value New Zealand), Inland Revenue will not use s 17 and will meet the usual charges.

Before issuing a s 17 notice, Inland Revenue will have considered the following factors:

(a) The reason for requiring the information — only information considered necessary or relevant under the circumstances will be required;

(b) The impact of the demand on the suppliers of information — Inland Revenue will be reasonable in relation to the quantity and/or time-frame for providing the information. Reconsideration of the demand will occur where there is genuine difficulty in obtaining the information;

(c) Previous requests for information or attempts to resolve disputes — generally, where the taxpayer or their authorised adviser wishes to claim the right of non-disclosure, a s 17 notice will be issued only following a failure to provide information previously requested or attempted resolution of issues has failed;

(d) Whether the CIR requires disclosure of tax contextual information — the notice will generally advise that such disclosure if necessary will be required in a subsequent notice;

(e) The effect of the disputes resolution process — this process relies on full and prompt disclosure by both parties;

(f) Inland Revenue’s intention to ensure compliance with the notice — s 17 notices are generally used only where Inland Revenue are prepared to invoke statutory remedies in the event of non-compliance;

(g) The use of s 16 powers — in some cases Inland Revenue will use its powers to enter premises for the purpose of inspecting documents; and

(h) Requests for significant amounts of documentation — where the amount of required documentation is significant, it will generally be able to be sent to the nearest Inland Revenue office.

Generally, a s 17 notice will only be issued following a failure to provide information previously requested, or where specific issues have been identified and an attempt to resolve those issues has failed. Where non-compliance occurs, a follow up notice will be issued stating that the s 17 notice has not been complied with, Court orders are being sought, and/or prosecution action is being considered.

Where requests are made to persons other than the taxpayer, the procedure usually begins with a letter. It may follow a discussion. Where this request is not complied with, the above process is commenced to obtain the information.

See TIB vol 17:6 (August 2005) at 37-51 for the complete statement, including examples of s 17 notices and third party information request letters used by Inland Revenue.

790.33 Giving of notice by CIR [TAA, s 14]

Where the CIR is required to give a notice (for example, a s 17 (TAA) notice), to any person under the TAA or any other Act, the notice must be in writing and must be delivered to either the person or a representative who is authorised to act on behalf of the person.

There are various methods of delivery available to the CIR:

(a) Personal delivery where the addressee is not a corporate body;
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(b) Where the person is a corporate body, personal delivery to the addressee’s office during working hours;
(c) By electronic means unless there are reasonable grounds to suppose that the notice will not be received;
(d) By post to the street address of the person’s usual or last known place of residence or business or to any other address where the person has notified the person that they accept notices at that address. A notice sent by post is deemed to have been received when it would have been delivered in the normal course of post.

In *Hieber v Commissioner of Inland Revenue* (2002) 20 NZTC 17,562 (HC), the High Court held that a post box could be a place of business, for the purposes of receiving mail, where that was the only address supplied. The Court expressed the opinion that an email address may also suffice as a place of business for the purposes of s 14 of the TAA. The wording of s 14 of the TAA is directory not mandatory — the word “may” must not be construed as “shall”. As a general rule, notice to one partner in a firm is notice to all other partners; and a notice to one trustee is notice to all trustees of a trust.

In *Commissioner of Inland Revenue v Thompson* (2007) 23 NZTC 21,375 (HC), the High Court held that the CIR had not complied with s 14 of the TAA by sending the NOR by post to the accountant who had served the NOPA, because the accountant was not the taxpayer’s designated agent. Another firm was clearly designated on the NOPA coversheet as being the taxpayer’s agent for service.

790.35 Court order for production of information or return [TAA, s 17A]

If a person fails to provide information to the CIR as required by a written notice under s 17 of the TAA within the time limit specified, or fails to provide a tax return on time, the CIR may apply to the District Court for an order requiring the person to produce the information for review or to provide the tax return. This option is available to the CIR as well as, or instead of, prosecuting the taxpayer. The CIR must give notice of the application to the person in respect of whom the order is sought and to any other person the District Court directs. The CIR and each person who is given notice of an application is entitled to appear and to be heard on the hearing of the application.

The District Court may order the information requested under s 17 of the TAA be produced to the Court. The Court will then review the information to determine whether to make an order requiring the taxpayer to produce the information to the CIR, whether the information is the subject of legal professional privilege (within the meaning of s 20 of the TAA or otherwise at law), whether the information is contained in a “tax advice document”, and whether the information is “tax contextual information” [see 790.61]. If the District Court is satisfied that the information is likely to be relevant to the administration or enforcement of a tax law or any other function lawfully conferred on the CIR, and it is not the subject of legal professional privilege, the District Court may order the person named in the application to produce the information to the CIR and order the taxpayer named in the application to provide a tax return.

The District Court may make such orders even if an enactment or rule of law obliges a taxpayer not to disclose information, or to keep information secret, or not to perform an obligation. A taxpayer cannot breach any enactment, rule, or obligation by complying with an order under s 17A of the TAA.

A person cannot refuse to produce information that is the subject of a Court order on the grounds that:
(a) Production of the information might be a breach of a tax obligation or subject the taxpayer to a fine, penalty, or conviction; or
(b) Another privilege could otherwise be claimed by the taxpayer in relation to production of the information in proceedings in a Court.

Information produced to the CIR as a result of a Court order under s 17A of the TAA may be removed and retained by the CIR for so long as is necessary to undertake a full review, and may be copied by the CIR without liability for a fee or payment. If the information is not in written form, the person who produced the information must ensure that the information can be viewed and copied by the CIR.
790.40 Inquiries before a District Court Judge [TAA, s 18]

The CIR has power to hold an inquiry before a District Court Judge for enforcing the tax legislation. The Judge may summon and examine on oath all persons whom the CIR or other interested persons may require to be called and examined. The inquiry is held in chambers.

790.50 Specific powers given to CIR [TAA, s 19]

The CIR may, in order to obtain any information to determine the tax or duty liability of any person, require any person to attend and give evidence and to produce all documents held by that person which contain or are likely to contain any relevant information. The CIR may also require any evidence to be given on oath and either orally or in writing.

A person commits an offence who refuses to give evidence, or refuses or wilfully neglects to appear or to take an oath, or if sworn in as a witness at an inquiry refuses or wilfully neglects to answer any question, or to produce any relevant document [TAA, s 214]. The perjury provisions of the Crimes Act 1961 are applicable to any inquiry. Persons required to attend an inquiry may be awarded reimbursement for travelling expenses and loss of time.

790.60 Legal privilege — the solicitor-client relationship [TAA, s 20]

The legislation was originally inspired by the case of Commissioner of Inland Revenue v West-Walker [1954] NZLR 191 (CA), when a solicitor was held to be entitled to decline to furnish to the CIR information protected against disclosure by common law privilege for professional advice and assistance without the previous assent of the client concerned.

The legislation provides that any information or document is privileged from disclosure if it is a confidential communication, whether oral or written, passing between a legal practitioner and another legal practitioner in their professional capacities; or between a legal practitioner in a professional capacity and a client. The evidence is privileged from disclosure if it was made or brought into existence to obtain or give legal advice or assistance, but not if it was made for committing some illegal or wrongful act.

Legal professional privilege is not, under s 20(1)(c) of the TAA, lost in respect of a communication, unless in the course of legal proceedings in which the evidence is tendered, it was definitely charged (rather than merely contended), that the communication was itself a step in the commission of a crime or preparatory to or in aid of the commission of a crime or in aid of civil fraud: TRA Case W17 (2003) 21 NZTC 11,172.

Where the evidence consists of the receipts (including investment receipts), payments, income, expenditure or financial transactions it is not privileged from disclosure if it refers to the trust account of the legal practitioner. The CIR may apply to a District Court Judge for an order determining whether or not the claim of privilege is valid in any set of circumstances.

Legal professional privilege, litigation privilege, and waiver of privilege were considered in Dinsdale v Commissioner of Inland Revenue (1997) 18 NZTC 13,244 (HC). This case arose as a result of a request by Inland Revenue, under s 17 of the TAA, for interview notes prepared by a firm of chartered accountants in the course of an audit of bank documents. The audit was conducted, at the request of the bank and under the supervision of a solicitor, for the purpose of satisfying Inland Revenue that all documents relating to a redeemable preference share transaction had been provided to Inland Revenue. Inland Revenue had threatened to prosecute the under (now repealed) s 199(1)(b) of the TAA for failure to disclose, and required the bank to provide a statutory declaration to the effect that all documents relating to the transaction had been made available to Inland Revenue. The bank, following advice, instructed its solicitor to carry out the audit. A letter from the solicitor requesting the assistance of the firm of chartered accountants stated that the purpose of the audit was to provide background information in relation to the threatened prosecution and to enable the bank to provide the statutory declaration confident in the knowledge that it was true. The letter further stated that all communications and inquiries relating to the audit would be subject to litigation privilege. In carrying out the audit, the firm of chartered accountants interviewed a number of present and former employees and professional advisers of the bank, and prepared notes of each interview. Following its audit, the firm of chartered accountants delivered a report to Inland Revenue setting out the work it had done,
providing further relevant documents it had found, and expressing the view that there had been no intention by the bank to mislead Inland Revenue. At the same time, the bank provided Inland Revenue with the requested statutory declaration. Inland Revenue then requested the notes of some of the interviews. The bank declined to provide these, claiming legal professional privilege and litigation privilege.

The Court found that Inland Revenue’s request for the interview notes under s 17 of the TAA was not invalid by reason of legal professional privilege or litigation privilege. Reasons given for the decision were:

(a) Legal professional privilege did not apply because the interview notes were communications between a solicitor and third parties, not between a solicitor and client.
(b) Litigation privilege also did not apply. There were reasonable grounds for the bank to apprehend that it would be prosecuted, but the claim failed on the dominant purpose test. While litigation was one of the purposes, the dominant purposes of the interview notes were to enable the bank to comply with the request for a statutory declaration and to explain to Inland Revenue why it had failed to provide all relevant material earlier.
(c) The bank had not impliedly waived its right to claim privilege by referring to the interview notes in the report but not making them available. The Court expressed the view that if the report had been produced as evidence in litigation, the result would have been different.

The decision provides a useful summary of the law relating to legal professional privilege, litigation privilege, and waiver of privilege.

In Dinsdale v Commissioner of Inland Revenue (1998) 18 NZTC 13,583 (CA) the Court of Appeal confirmed the earlier High Court decision that litigation privilege could not be claimed in respect of the interview notes because the dominant purpose of bringing them into existence was to help ascertain that all relevant documents in the possession or under the control of the bank had been or were made available to Inland Revenue. The parallel purpose of gathering information that might be helpful in the defence of a threatened prosecution was at best an equal purpose, not a dominant one. The presence of a lawyer at the interviews does not of itself confer privilege on interview notes, particularly when they are not the lawyer’s notes.

Litigation privilege is only available to a litigant when two criteria are met. First, litigation must be in train or at least reasonably apprehended. Privilege cannot be claimed for documents prepared before that time. Secondly, the relevant document must be one which was prepared with the dominant purpose of enabling legal advice to be received in relation to that litigation: Glenharrow Holdings Ltd v Commissioner of Inland Revenue (2002) 20 NZTC 17,792 (HC).

In TRA Case T32 (1997) 18 NZTC 8,221, legal opinions and reports prepared by Inland Revenue lawyers and used by Inland Revenue staff in the making of executive decisions were held to be protected by legal professional privilege. The opinions were not created as part of an executive function of Inland Revenue—their dominant purpose was providing legal advice. In writing the opinions, the Inland Revenue lawyers were acting as lawyers and not as employees. To determine whether a communication is privileged it is the role of the writer of the opinion which must be considered, not the consequence of the opinion. Privilege also attaches to drafts and preparatory notes prepared by the opinion writer.


At common law, no privilege exists to protect confidential communications between an accountant and their client. Professional privilege has traditionally been available only to lawyers in respect of confidential communications with their clients in relation to tax matters [see 790.60]. From 21 June 2005, all requests from the CIR or discovery obligations for tax advice documents are subject to a statutory privilege (ie a new non-disclosure right). The requests can relate to any tax periods.

(1) Who is protected? [TAA, s 20B(5)]

Statutory privilege applies only to tax advice provided by members of an approved adviser group, where the group has a significant function of providing tax advice and members are subject to a professional code of
(2) **What is protected?**

Statutory privilege applies to communications between tax advisers and their clients for the purpose of requesting or providing tax advice. However, this non-disclosure right is subject to a number of exclusions (i.e., factual information, debt collection advice, and accounting and tax work papers). Tax advice does not include valuation or investment advice. Similar to legal professional privilege, it does not apply in matters of fraud.

**TaxNote:** Legal privilege is not statutory privilege. While they might appear the same in some respects, they are not the same. The new statutory privilege rules do not affect common law legal privilege rules.

Statutory privilege applies to requests made after 21 June 2005 relating to any period.

Statutory privilege is extended to discovery proceedings during litigation. The extension applies to:

(a) Challenges commenced from 6 October 2009;

(b) Challenges commenced before 6 October 2009, if all of the following conditions are met as at 6 October 2009:

   (i) No case management conference or directions hearing for the challenge has been held by a Court or the TRA;

   (ii) No direction has been made by a Court or the TRA that a case management conference or a directions hearing be held; and

   (iii) The issues raised by the challenge are not substantially similar to issues being considered by a Court or the TRA in another challenge.

(3) **What is not protected?**

A statutory declaration may need to be provided to Inland Revenue where information contains factual information (e.g., advice on debt collection, or accounting and tax work papers). Section 20F of the TAA requires the tax adviser to provide a statutory declaration of tax contextual information not contained in a privileged document. The provision of a statutory declaration should be required only as a last resort. In most cases, only unprivileged material should be provided in response to a request for information and Inland Revenue should consider that material to assess whether it is sufficient to complete the investigation. A statutory declaration would generally be requested only if the non-privileged documents were not sufficient. In some cases, it may be necessary for Inland Revenue to accompany a request for information with a request for a statutory declaration of tax contextual information if the declaration is considered necessary for proper administration of the revenue.

(4) **What is a tax advice document?**

The right to non-disclosure applies only to a “tax advice document”. This is defined to mean a document that:

(a) Is confidential; and

(b) Has been created for the main purpose of instructing a tax adviser in the provision of advice regarding the operation and effect of tax laws; or

(c) Has been created by a tax adviser (or tax adviser’s employee) for the purpose of either recording research and analysis to enable the adviser to give the advice, or the giving of giving that advice; and

(d) In any case, has not been created for the purpose of committing or promoting an illegal act.

The term “tax law” includes the Revenue Acts, an Order in Council or regulation, a non-disputable decision and, in relation to the filing of returns, also includes ACC legislation. It does not include the tax laws of foreign jurisdictions.
The term “tax adviser” means a natural person who is subject to the code of conduct and disciplinary processes of an “approved adviser group”. The New Zealand Institute of Chartered Accountants has been approved as an approved adviser group.

In order for a tax advice document to be subject to non-disclosure, a valid claim for non-disclosure must be made under s 20E of the TAA. Where a valid claim is made, non-disclosure applies from the date on which the information request was made or the discovery obligation arises [TAA, s 20C]. Only the actual document and attachments that form part of that document will be protected from disclosure. Other attachments (i.e. a sale and purchase agreement) that do not form part of the document are not protected [TAA, s 20E].

In Commissioner of Inland Revenue v Blakeley [2008] DCR 415, (2008) 23 NZTC 21,681 (DC), the CIR obtained four tax opinions prepared by a chartered accountant. The CIR considered that the arrangement referred to in the opinion was tax avoidance. The accountant disclosed to the CIR that similar advice had been provided to other clients. A notice was issued under s 17 of the TAA requesting the accountant to provide the names of the taxpayers to whom the advice had been provided. The notice was not complied with and the accountant argued that providing that information would be in breach of his clients’ non-disclosure rights as the CIR would know the content of the advice that had been given to them. In finding for the CIR, the District Court found that the enforceability of the notice could not be avoided by an accountant advising that the same advice had been given to other clients and that s 20B of the TAA requires the identification of a particular book or document in respect of which the non-disclosure right is claimed. The High Court dismissed Mr Blakeley’s appeal and held that the District Court was correct to find that the statutory protection was not available, see (10) below.

(5) Tax contextual information [TAA, s 20F]

In most cases, a request will first be made for non-protected information. In the event that this is not sufficient for the completion of the investigation, a request for tax contextual information may be made. Where this occurs, tax contextual information included in the protected document will have to be disclosed by way of a statutory declaration. This declaration should reflect the tax adviser’s view of the relevant transactions. Alternatively, the adviser may disclose the information verbatim.

“Tax contextual information” includes such things as:
(a) Facts and assumptions provided in contemplation of actual transactions entered into by the taxpayer;
(b) Steps involved in a transaction;
(c) Advice on matters other than tax law;
(d) Advice on the collection of tax debts;
(e) Facts and assumptions relating to matters other than tax advice; accounting and tax workpapers.

Where the information request is made under s 17 of the TAA, the description of the tax contextual information must me provided by the later of the day prescribed by the CIR or 28 days following the information request. If the information demand is made under s 16 of the TAA (Commissioner’s right to enter premises), s 16B of the TAA (Commissioner’s right to seize documents) or s 16C of the TAA (Power to remove and retain documents for inspection) and the taxpayer claims the right of non-disclosure, the tax contextual information must be disclosed by the date determined by the CIR. Where the demand is made under s 17A of the TAA (Court order), s 18 of the TAA (District Court Judge) or s 19 of the TAA (Inquiry by CIR) a date will be set by which the information must be provided.

A tax adviser can be barred from making a statutory declaration if convicted of certain offences.

(6) Challenges [TAA, s 20G]

Both the taxpayer and the CIR have the right to apply to the District Court for an order as to:
(a) Whether a document constitutes a “tax advice document”;
(b) Whether information is “tax contextual information”;
(c) A more detailed or better description of the tax contextual information that is required.

The judge has the ability to require the document in question to be produced to the Court.
(7) **Secrecy [TAA, s 81B]**

Section 81B of the TAA provides the CIR with the ability to divulge information to an approved adviser group regarding a member who breaches the non-disclosure rules. The could result in the approved adviser group taking disciplinary action against the member.

(8) **Inland Revenue guidelines**

The CIR has issued a standard practice statement SPS 05/07: *Non-disclosure right for tax advice documents*, which outlines the process and operational guidelines to be followed when the CIR issues “Information Demands” to taxpayers, their agents, or to third parties [see TIB vol 17:6 (August 2005) at 23-36].

**TaxNote**: An Inland Revenue information demand may require disclosure of documents that contain tax advice and subject to the right to a claim of non-disclosure.

(9) **Summary of Process**

The process for claiming the right of non-disclosure is outlined below:

**Step 1**

Information Demand made under ss 16-19 TAA seeking documents which may be eligible to be tax advice documents. In special circumstances, Information Demand may include requirement to disclose the tax contextual information if the right to claim non-disclosure is claimed for tax advice documents.

**Step 2**

Taxpayer (or their authorised tax advisor) claims non-disclosure right for documents eligible to be tax advice documents by providing the completed IR519 form.

Taxpayer (or their authorised tax advisor) provides tax contextual information if requirement to disclose is included in the Information Demand by providing completed IR520 form.

CIR or taxpayer may challenge claim that a document is a tax advice document by making an application to the District Court, a Court, or TRA, where the claim is made in response to a discovery obligation in proceedings before that jurisdiction.

**Step 3**

Taxpayer (or their authorised tax advisor) provides tax contextual information if required to disclose in subsequent Information Demand by providing completed IR520 form.

Taxpayer (or their authorised tax advisor) may waive non-disclosure right and provide the tax advice documents to the CIR.

**Step 3**

District Court, a Court, or TRA will determine whether the document is a tax advice document.
(Cases)

In Commissioner of Inland Revenue v Blakeley [2008] DCR 415, (2008) 23 NZTC 21,681 (DC), the District Court held that the taxpayer accountant could not refuse to provide a list of client names to the CIR simply on the grounds that provision of such a list would enable the CIR to determine the persons to whom the taxpayer had provided tax advice relating to certain tax avoidance lease arrangements. Mr Blakeley appealed that decision. He contended that the list of names and IRD numbers of clients was protected from disclosure under s 20B of the TAA; (the other grounds of appeal were that there had been no waiver of privilege; and that it would have been impossible for him to comply with the notice): Blakeley v Commissioner of Inland Revenue (2008) 23 NZTC 21,865 (HC). The High Court dismissed the appeal and held:

(a) The powers that s 17 provides the CIR for the purpose of facilitating the proper discharge of his statutory functions are expressed in the widest terms, Commissioner of Inland Revenue v New Zealand Stock Exchange [1990] 3 NZLR 333 (CA) applied.

(b) Section 17 is subject to legal professional privilege, (ss 20B-20G of the TAA). The protection afforded by s 20B is much more confined than legal professional privilege. It is not a new substantive right of equivalent utility to legal professional privilege. The statutory protection created for tax advice documents is significantly narrower that the scope of legal professional privilege both as to the information protected from disclosure and the conditions attaching to its application. The statute should not be construed as if it were an extension to legal professional privilege. Sections 20B-20G provides taxpayers with a new but strictly circumscribed right to resist the exercise by the CIR of wide ranging information gathering powers. Unlike legal professional privilege It is not a response to public interest considerations but a creature of statute protecting defined parts of a limited category of written communications.

(c) The District Court was correct to find that the statutory protection was not available. The names and IRD numbers are not a tax advice document for the purpose of s 20B nor are they a document as stipulated in s 20B(2) and defined in s 3 of the TAA.

790.70 Offshore payment information requisitions

The CIR has wide powers to disallow deductions for offshore payments if a taxpayer fails to respond to information requisitions within the statutory time limit.

“Offshore payment” means an amount of expenditure or loss incurred or purportedly incurred by a taxpayer (on or after 1 August 1986) to a person outside New Zealand or to a person associated with a person outside New Zealand. The associated person may be either inside or outside New Zealand. An associated person includes a person acting for or on behalf of or in a fiduciary capacity in relation to a person outside New Zealand.

“Information requisition” means a written notification supplied by the CIR:

(a) Giving notice to a person of the exercise by the CIR of any power under s 17 of the TAA [see 790.30 and 790.32]; and

(b) Requiring the person to supply information in writing, produce documents for inspection, or to verify by statutory declaration (or otherwise) any information specified in the notice.

“Associated person” is defined in 70.20.

An information requisition may be sent by the CIR either to the taxpayer who is claiming the deduction for the offshore payment or to any other person who may have relevant information. If an information requisition is given to a person other than the taxpayer who is claiming the deduction, a copy of the requisition must be given to the taxpayer.

The CIR may wholly or partly disallow a deduction claimed for an offshore payment if:

(a) A taxpayer fails to respond to an information requisition within 90 days of the date the requisition was mailed to the taxpayer; or
790.80  

(b) The information requisition has been sent to a person other than the taxpayer, and both the taxpayer and that other person have failed to respond within the 90-day period.

A response that does not contain the information requested by the CIR in the requisition will be deemed not to be a response for the purposes of s 21 of the TAA. A taxpayer therefore cannot safeguard a deduction merely submitting a non-substantive response.

The taxpayer also loses the right to dispute an assessment, to the extent that it relates to an offshore payment, in any objection or challenge proceedings if the taxpayer, or other person, fails to respond to an offshore payment information requisition within 90 days.

Even if a taxpayer responds to an information requisition within the required time-frame, an evidence exclusion rule prevents the taxpayer from admitting, in any objection or challenge proceedings, any evidence not provided to the CIR prior to or in response to the requisition. However, this restriction does not prevent the CIR from adducing any evidence in any proceedings. In order for the evidence exclusion rule to apply, the CIR must issue a notice prior to or at the same time as an assessment notice informing the taxpayer that insufficient information has been furnished to support a deduction for the offshore payment.

An information requisition given by the CIR to an agent for a partnership or to a partner in a partnership is deemed to be given to every partner in the partnership. This applies whether the partnership is extant or defunct: *Hieber v Commissioner of Inland Revenue* (2002) 20 NZTC 17,562 (HC). Master Kennedy-Grant was also of the opinion that it was sufficient to address an information request to one trustee of a trust in order for it to apply to all trustees.

790.80  

Business group amnesties [TAA, s 226B]

In order to encourage voluntary compliance by taxpayers with their tax obligations, the CIR may declare a business group amnesty if the CIR considers that the amnesty is consistent with the protection of the integrity of the tax system and the collection over time of the highest net revenue practicable within the law. An amnesty applies to a group of persons each of whom carries on a specified type of activity as their main business (the “affected business”).

When declaring a business group amnesty, the CIR will announce the start and end days of the amnesty. The CIR may change these days by announcing the change on or before the day concerned.

A person is eligible to benefit from a business group amnesty if the person:

(a) Is carrying on the affected business when the amnesty becomes available;

(b) Has carried on the affected business throughout the three income years ending before the income year in which the amnesty becomes available;

(c) Has not previously benefitted from a business group amnesty; and

(d) Has not been notified of a pending tax audit or investigation before the amnesty becomes available.

During the period of the amnesty, a person wishing to take advantage of the amnesty must give the CIR a notice:

(a) Stating that they wish to benefit from the amnesty;

(b) Stating that they are carrying on the affected business;

(c) Stating the period for which, and the place where, they have carried on the affected business;

(d) Providing a statement of assets and liabilities for the income year ending before the income year in which the amnesty is available;

(e) Giving details of actions and omissions relating to the business that they consider might give rise to an assessment, amended assessment or prosecution if they did not benefit from the amnesty; and

(f) Providing any other information required by the CIR.

A person (an “affected person”) benefits from an amnesty if the person is eligible to benefit from an amnesty and gives notice as above.

Despite the business group amnesty, the CIR may investigate the financial affairs of an affected person for:
(a) The income year that ends before the income year in which the amnesty is declared; and
(b) The income year in which the amnesty is declared.

Following the investigation, the CIR may make an assessment or amended assessment of the affected person for the two years referred to above.

After an affected person gives notice to the CIR (as above), the CIR must not, for income years before the two income years referred to above:

(a) Begin an investigation of the income and deductions of the affected person relating to the affected business; or

(b) Make an assessment or amended assessment of the affected person based on figures other than those included in a return of income provided before the date of the notice referred to above (subject to the exception below).

After an affected person gives notice to the CIR, the CIR must not begin a prosecution of the affected person for an action or omission before, or in giving, the notice if the affected person provides information relating to the action or omission to the CIR.

Example:
The CIR declares a business group amnesty for a period of three months commencing on 1 May 20X4. A person (with a 31 March balance date) who is eligible under the amnesty provides the CIR with the required notice. The CIR may investigate the person’s financial affairs and, if applicable, issue assessments or amended assessments for the years ending 31 March 20X4 and 31 March 20X5. However, for earlier income year, the person is protected by the amnesty in relation to their affected business.

An amnesty does not protect an affected person from being assessed, reassessed or prosecuted if the assessment or prosecution arises from an investigation that the person was notified of, and that the CIR began, before the person gave notice to the CIR. The CIR is required to report in writing to the Minister on the results of a business group amnesty, and the Minister must lay a copy of the report before the House of Representatives.
Chapter 800

Insurance Industry

800.10 Income of life insurers
The ITA 2007 provides a comprehensive regime under which a life insurer calculates income from its underwriting function and its function as a financial intermediary for policyholders. The provisions also address consequences arising from changes in the capital structure of a life insurer (e.g., in a demutualisation) and in acquisition and merger activity. The taxation of life insurance was changed significantly with effect from 1 July 2010. The regime also extends the benefits of the Portfolio Investment Entity (PIE) regime to people who invest in insurance products [see 1130].

Transitional rules apply to facilitate the change to the new rules [see 800.55].

For income tax purposes, the life insurer’s taxable income is a benefit accruing to shareholders (the life insurer base). The life insurer is also taxable on income accruing for the benefit of policyholders (the policyholder base).

A “life insurer” is a person who carries on the business of providing life insurance. It does not include such a person while that person has full reinsurance. Mutual associations and trusts that provide benefits that are contingent on death or survival of a human being (other than in consideration of natural love and affection) are taxed as if they are in the business of providing life insurance and not as a mutual association [s EY 10].

800.15 Calculation of life insurer net income [ss CR 1, CR 2, CW 59C, DR 1, DR 2, DR 3, DR 4, subpart EY]
Life insurers determine their income and deductions under the normal rules contained in the ITA 2007. However, due to the particular nature of the life insurance contract and aspects of life insurance business, there are some specific provisions that govern what is assessable and what is deductible to a life insurer.

A life insurer is taxable on income attributable to both its policyholder base and its shareholder base [ss CR 1, CR 2].

The rules contained in subpart EY of the Act provide that certain amounts that may not be assessable or deductible under ordinary concepts are assessable or deductible to a life insurer. Sections DR 1 and DR 2 confirm the deductibility of these amounts.

A life insurer is not entitled to a deduction for life reinsurance premiums incurred unless the reinsurance policy was offered in New Zealand and/or entered into in New Zealand. Accordingly, the life insurer is not
taxable on the amount any life reinsurance claim under a reinsurance policy where the premiums paid are not deductible. The amount is, instead exempt income of the life insurer [ss DR 3, CW 59C].

Life insurers are entitled to a deduction for claims actually paid under a life insurance policy during the income year. They are not entitled to a deduction for any provision for outstanding claims that have not actually been paid (known as the “outstanding claims reserve”) [s DR 4]. The calculations contained in subpart EY relating to which income amounts are included in the policyholder base and which in the shareholder base include as assessable income premiums to the extent to which they relate to the life risk component of a life insurance policy. Taking these provisions together, the insurer is taxable on risk premium income and is allowed a deduction for life insurance claims paid.

800.20 Policyholder base [ss EY 15, EY 16, EY 17, EY 18]

The net income that is attributed to a policyholder base does not include the life risk component of premiums and claims. These belong in the shareholder base. Policyholder base income is the investment income that is fairly attributable to the savings element of policies. This means that investment income needs to be apportioned between the policyholder bases and the shareholder base. Section EY 15 provides an actuarial-based formula for this calculation for non-participation policies and s EY 17 provides an actuarial-based formula for profit-participation policies.

Deductions against this investment income also need to be apportioned between the policyholder base and the shareholder base. The basis for apportionment is the same as for the income [ss EY 16, EY 17].

800.25 Shareholder base [ss EY 19, EY 20, EY 21, EY 22]

The income of the shareholder base includes:

• The life-risk component of premiums;
• Fees and commissions;
• The life-risk component of life reinsurance claims; and
• Investment income that is not properly attributable to the policyholder base.

These amounts are governed by the provisions of s EY 19 in respect of non-participation policies and s EY 21 in respect of profit participation policies. Section EY 21 includes an actuarial-based formula to enable the apportionment of investment income to be done.

Sections EY 20 and EY 22 contain the basis for establishing the amount of deductions that are deductible against the shareholder base income.

800.30 Reserves [ss EY 23, EY 24, EY 25, EY 26, EY 27]

(1) General requirements

Although life insurers are taxed under normal tax principles, the nature of the industry gives rise to tax issues that are addressed by special rules. These rules include a number of provisions relating to reserves.

Claims may be incurred by reason of, for example, the death of the life insured. Where that claim has not been reported by the end of the income year, or has been reported but not paid, insurers are able to use the “outstanding claims reserve” under s EY 24 to account for the outstanding liability.

Some products produce uneven cash flows. For example, large amounts of premium income can be received in the early years of a policy’s life followed by large payouts for claims some years later. To alleviate the effects of these cash flows, the industry uses reserving methods, based on actuarial principles, to even out the net income effect. Sections EY 25 and EY 26 provide for the “unearned premium reserve” and the “premium smoothing reserve” to alleviate this problem.

Some policies provide a guaranteed minimum return. The “capital guarantee reserve”, provided under s EY 27, accommodates the top-ups provided by the shareholders for policyholders’ future claims under the guarantee.
Section EY 23 provides that the reserving provisions apply only to non-participating life products that are term insurance or savings products. They do not apply to annuities or products that include participation in profits.

All movements in the reserve balances must be calculated in accordance with actuarial principles.

2) Outstanding claims reserve [ss EY 23, EY 24]

Section EY 24 provides for the “outstanding claims reserve” (OCR) which relates to claims which have occurred but have not yet been reported or have not yet been paid out. Movements in the OCR are taken into account for tax purposes. Decreases in the reserve result in income. Increases in the reserve are an allowable deduction.

Claims that are recognised in an income year earlier than that in which they are paid out are required to be discounted to present value using the risk-free rate of return. Where the discount period is less than one year, no present value calculation is required. An appropriate risk margin is added to the estimated and actual values of the life risk claims incurred and reported unless the amount of the claim is known. Where the amount is known, no risk margin is added.

3) Unearned premium reserve and premium smoothing reserve [ss EY 23, EY 25, EY 26]

Insurers are able to elect to use one or the other of the “unearned premium reserve” (UPR) or the “premium smoothing reserve” (PSR). Once the choice of reserving method has been applied to a class of policy, the decision is irrevocable. The one exception is where the PSR has been chosen and is no longer able to be used. In this case, the UPR must be used from that point in time.

Restrictions apply to the use of the PSR. It can be used only for:

(a) Products that have level, or substantially level, premiums for more than one year; or
(b) Products that could result in a material mismatch in any one year between the life risk components and the timing of the payment of premiums. The period can be one or more years.

Policies can be grouped together if they have substantially the same terms and conditions (other than duration of the policy) and substantially the same pricing assumptions in respect of their life risk.

Decreases in the reserves result in income. Increases in the reserves are an allowable deduction.

4) Capital guarantee reserve [s EY 27]

The “capital guarantee reserve” (CGR) represents amounts provided by shareholders to top up policyholders’ future claims where the policy has a guaranteed return. Top-ups may be required when investment returns are low. When investment returns are high, amounts over the guaranteed return rate may be transferred to the reserve to support future demand. Increases in the reserve result in income for the shareholder base and a deduction in the policyholder base. Decreases give rise to an allowable deduction in the shareholder base and income in the policyholder base. Where shareholders are required to make an actual cash injection to the reserve, it will be deductible in the shareholder base but no corresponding adjustment is made in the policyholder base. However, any loss that caused the reduction in capital is not deductible.

800.35 Non-resident life insurer issuing policies in New Zealand [ss EY 48, EY 49]

Where a life insurer not resident in New Zealand offers; is offered or enters into life insurance policies in New Zealand, s EY 48 provides the basis for calculating the income from that business. The amount is then deemed to be New Zealand sourced income.

The items in the premium loading formula, mortality profit formula, discontinuance profit formula and policyholder income formula are applied only to:

(a) Policies that the insurer offered, was offered or entered into in New Zealand; and
(b) Life reinsurance policies held by the insurer that relate exclusively to life policies that the insurer offered, was offered or entered into in New Zealand.
Any other income of the life insurer which is derived from the business of providing life insurance is also
determined only in relation to the insurer’s New Zealand business.
Non-resident life insurers may elect with the approval of the CIR to be treated as though the business of
providing life insurance was carried on by a company resident in New Zealand.

**800.40 Superannuation schemes providing life insurance to members and
beneficiaries** [s EY 11]

The provision of life insurance by a trustee to members or beneficiaries of a superannuation scheme is treated
as if it were the provision of life insurance.

Superannuation funds are deemed not to carry on the business of life insurance if all of the following
requirements are met at all times during the income year:

(a) The fund is registered by the Government Actuary under the Superannuation Schemes Act 1989;

(b) No trustee of the fund is a company carrying on the business of providing life insurance to which
the Life Insurance Act 1908 applies;

(c) The fund is either established by an employer (or a group of employers who are associated) to provide
benefits to employees of the employer or associated employer or is constituted under an Act relating
to the National Provident Fund Restructuring Act 1990, the National Provident Fund Act 1950 or
the Government Superannuation Fund Act 1956;

(d) Each beneficiary of the fund is:
   (i) A natural person who is an employee of the employer;
   (ii) In the case of the National Provident fund, a natural person who is a beneficiary of the fund; or
   (iii) An employer of members of the fund, to the extent of the employer’s contingent interest in
        a fund surplus;

(e) Each employer is required by the trust deed or Act constituting the fund to make contributions to
provide to a significant extent the benefits payable by the fund and not merely nominal contributions
        towards the administration and investment management costs; and

(f) The fund must not have been established to defeat the intent and application of the life insurance
rules.

Written approval of the Government Actuary is required stating that the fund complies with all of the above
requirements.

Where a superannuation fund fails to meet the requirements of item (e) above, that fund is nevertheless treated
as complying if the Government Actuary is satisfied that each employer would be required to make
superannuation contributions to the superannuation fund to provide to a significant extent the benefits payable
by the superannuation fund were it not that the assets of the fund exceed the accrued benefits of all members
and other beneficiaries of the fund.

Where the Government Actuary ceases to be satisfied that the superannuation fund should qualify, it loses
that status as from a date specified by the Actuary. The Government Actuary must notify the trustee of the
superannuation fund in writing as soon as practicable after determining whether or not a superannuation fund
is a qualifying superannuation fund. Any person who is dissatisfied with any such determination may object
to the determination under the Superannuation Schemes Act 1989, but not under the TAA 1994.

Superannuation schemes administered by the Board of Trustees of the National Provident fund are not subject
to the life insurance tax rules.

**800.45 Foreign insurance companies not carrying on business in New
Zealand** [ss CR 3, DW 3, HD 16, HD 17, YD 8]

This applies to insurance premiums or reimbursements of insurance premiums paid to non-resident insurers
for assets or risks situated in New Zealand, and to insurance premiums paid offshore by resident persons.
Insurance Industry

Where any non-resident insurer:

(a) Derives a premium for any insurance contract which is deemed to have a source in New Zealand;

and

(b) The premium is not attributable to a fixed establishment in New Zealand through which the insurer carries on business,

the insurer is deemed to have derived taxable income equal to 10 per cent of the gross premium. Income tax is assessed and levied at the rate for non-resident companies.

The amount of income tax for which the insurer is liable is determined finally and exclusively under this method. The premium is not otherwise included in the income of the insurer.

No deduction is allowed to the insurer for any expenditure or loss incurred by the insurer in gaining or producing the premium including any amount claimable under the contract of insurance by the insured person.

The following persons are deemed to be the agent of an insurer deriving such a premium and are required to make returns and be assessable and liable for income tax accordingly:

(a) Any person (including a broker or agent) who pays the premium to the insurer or to any other person not carrying on business through a fixed establishment in New Zealand. The payer has the primary responsibility as agent to make returns and pay income tax for the derivation by the insurer of the premium.

(b) Any other person who pays the premium (whether or not through a broker or agent).

(c) The insured person.

Where the insurer, or any other person on behalf of the insurer, makes returns and pays income tax for the derivation by the insurer of the premium, no other person is liable. The insured person is required to make returns and pay the income tax where neither the insurer nor any other person who is liable as agent of the insurer has done so.

Where any bank makes a payment of a premium on behalf of another person to the insurer, or to any other person not carrying on business through a fixed establishment in New Zealand, that bank is not treated as the agent of the insurer under these rules and the person who provides the bank with the funds from which the premium is paid is treated as the agent.

Any person who is treated as the agent of a non-resident insurer is to disclose in the company income tax return the amount of the premiums paid to residents of Switzerland or the Netherlands. Disclosure is made in the appropriate panel in the IR4 company return of income.

800.50 CFC life insurers [s EX 21]

Where a “controlled foreign company” (CFC) carries on a business of providing life insurance, or is owned by a CFC carrying on the business of providing life insurance, its income or loss will be the amount that is actuarially determined to be its profit or loss with which the shareholders (and not the policyholders) are attributed. This does not apply where the CIR considers that the amount so determined is not a reasonable and fair reflection of the relevant profit or loss, or has requested and not received sufficient information to enable the review of the actuarial calculation.

Foreign investment fund income or loss relating to a CFC life insurer which is determined to be an entitlement of the policyholders is not attributed to the New Zealand shareholders in the CFC life insurer.

These provisions are necessary because a CFC foreign life insurer’s income is mostly attributable to its foreign policyholders rather than its New Zealand shareholders. Therefore, it is not appropriate to attribute the policyholder-related income of a CFC life insurer or its lower tier CFC or foreign investment fund interests to its New Zealand shareholders.
800.55 Grand-parenting of term life products [ss EY 30, EZ 53, EZ 54, EZ 55, EZ 56, EZ 57, EZ 58, EZ 59, EZ 60, EZ 62, EZ 63]

Existing policies entered into prior to the introduction of the new rules are grand-parented and subject to transitional rules for a period of up to five years. Under the transitional grand-parenting rules, the tax treatment of these policies continues to be governed by the old rules. The transitional period of five years runs from 1 July 2010. Where the insurer has elected that the new regime apply from an earlier date, it can also elect that the grand-parenting provisions apply from that date.

The five-year transitional period is directed at annual renewable term policies. These policies are also referred to as yearly renewable policies or age-related term policies. For policies that have a single premium, level premium or guaranteed premium, the grand-parenting runs for the life of the policy, or the term over which the premium is guaranteed, even where this is greater than five years. Where a policy is changed and that change is material, it is considered to be a new contract and grand-parenting will cease to apply. An example would be where the level of cover is increased. The grand-parenting provisions are optional and insurers can elect out at any time.

Where CPI adjustments are an agreed part of a level premium policy, they do not cause the policy to lose transitional relief.

Elements of a life policy that are capable of being sold separately are able to be treated separately where the grand-parenting rules provide different treatments for the different elements.

Existing reinsurance contracts are able to be grand-parented to the extent to which the underlying life policy is also grand-parented and there are no material changes in the terms of the reinsurance contract.

There are special grand-parenting rules for multiple life policies, workplace group policies, credit card repayment insurance and life reinsurance.

(1) Multiple life policies

Where a number of people are covered under the same life policy (excluding workplace policies and credit card repayment insurance policies), the grand-parenting rules apply by looking at each of the policies and applying the following criteria:

(a) The policy was issued or a deposit paid prior to the start of the grand-parenting period;
(b) The insurer has no policyholder base income or policyholder base allowable deduction for that policy;
(c) The premium for each of the lives covered does not fluctuate;
(d) The material terms and conditions of the policy do not change on or after the start of the grand-parenting period; and
(e) Any increase in the amount of cover is limited to the greater of 10 per cent of the opening cover or the movement in the consumer price index. Where the policy is a reinsurance policy, and not all lives covered under the policy meet this requirement, grand-parenting can be applied to the extent to which the requirement is met.

Where the insurer’s systems allow it, the insurer may look separately at each life covered under the policy to determine whether a breach of the transitional rules has occurred. If a breach has occurred in respect of one of the lives but not others, grand-parenting can be applied to the part of the policy in respect of which no breach has occurred. For example, it may be that two lives are covered under the policy and there has been an increase in the amount of cover for one of the lives but not the other.

Part-year grand-parenting is allowed where a breach occurs part-way through the year.

(2) Workplace group policies

Workplace group policies will continue to be taxed under the old rules for a maximum of three years from the application date of the new rules. This grand-parenting is dependent on there being no savings element in the policy. It is also dependent on the substantive and material terms of the policy not changing during the period. The application of the grand-parenting concession is limited to rates that are guaranteed as at the
application date of the new rules. Originally, these policies were referred to in legislation as “employer-sponsored group policies” and the grand-parenting provisions applied for a period of five years. The reduction to three years was a trade-off for a relaxation in the requirement to look through the policy to the individuals. This allows employees lives insured after 1 July 2010 under a compulsory employer-provided group life policy to be grand-parented. A further change ensures that policies provided to trade unions to cover the lives of their members are treated in the same way.

Grand-parenting of workplace group policy reinsurance is based on whether the underlying policy is grand-parented.

(3) Credit card repayment insurance

For credit card repayment insurance, grand-parenting applies for five years. There is no requirement that the cover for each life insured be in place before the commencement date of the grand-parenting. Neither is there any limit imposed with respect to credit limit increases. This is because the insurer has no power to control credit limit increases that may be granted by the credit card provider. The requirement that the cover be provided under a master policy has been removed.

Grand-parenting of credit card repayment insurance policy reinsurance is based on whether the underlying policy is grand-parented.

(4) Life reinsurance

The definition of “multiple life policy” in s EY 30(14) includes life reinsurance, but only to the extent to which it does not reinsure a workplace group policy or credit card repayment insurance. Under s EY 30(14), it is necessary to look through the reinsurance treaty to the terms applying to the individual re-insured policies in order to determine the extent to which the transition rules apply. A special transition rule is provided under s EZ 62 in respect of life financial reinsurance entered into prior to the date on which the insurer first applies the new rules. The maximum transition period for life financial reinsurance is the shorter of the life of the contract or five years.

(5) Premium payback policies

The transitional rules apply to premium payback policies and ensure that and the policies can be grand-parented where they are entered into before the application date of the new rules. This is achieved by excluding them from the definition of “savings product policy” where the surrender value arises solely from a premium payback amount.

800.60 General insurance [ss CR 4, DW 4]

General insurers are taxable on premiums received and obtain a deduction for claims paid. At the end of an income year, insured events will have occurred which the insurer either:

• Has been advised of but has not yet paid; or
• Has not yet been advised of.

These are known as “outstanding claims”. Insurers estimate the value of these outstanding claims based on historic records and account for them through their “outstanding claims reserve” (OCR). Movements in the OCR are taken into account for tax purposes. Decreases in the reserve result in income. Increases in the reserve are an allowable deduction. Amounts calculated are required to be net of reinsurance and net of any other recoveries.

Movements in an insurer’s OCR are either taxable income or an allowable deduction, depending on whether the change in the reserve balance is negative (income) or positive (deduction). Section CR 4 provides that income arises for the insurer of the amount by which the opening OCR exceeds the closing OCR. Section DW 4 provides that a deduction is allowed to the extent to which the closing OCR exceeds the opening OCR. No deduction for an upward movement in the reserve is allowed other than under s DW 4.

For an insurer that uses IFRS 4, the amount of the opening and closing balances is the amount used for the insurer’s financial statements under IFRS 4. Life insurers who also offer general insurance contracts use a modified version of the calculation used for non-participation policies under the life insurance regime.
The new rules apply from the 2009-2010 income year for an insurer who uses IFRS 4. However, taxpayers are able to elect to apply the new rules from the beginning of the first income year in which IFRS 4 is adopted for financial reporting purposes where this is earlier. For a life insurer, the rules apply from 1 July 2010 or, at the taxpayer’s option, from the beginning of the income year that includes 1 July 2010.

Where insurance companies buy and sell investments (including freehold properties) on a regular basis, profits made on disposal constitute income: *London Australia Investment Co Ltd v Federal Commissioner of Taxation* (1977) 138 CLR 106, (1977) 7 ATR 757, 77 ATC 4,398 (HCA). However, where the facts indicate that the insurance company is holding the investments outside the insurance business, sales of those investments are capital receipts: *State Insurance Office v Commissioner of Inland Revenue* [1990] 2 NZLR 444, (1990) 12 NZTC 7,035 (HC), *Commissioner of Inland Revenue v National Insurance Co of New Zealand Ltd* (1999) 19 NZTC 15,135 (CA).

Insurance underwriters [s CX 41]

An underwriter is a person who is named in a contract of insurance as liable, or who otherwise incurs liability under a contract of insurance, to pay or contribute towards payment of any amount that may become claimable by the insured person under the contract.

The income of an underwriter from insurance business carried on out of New Zealand is excluded income. This exemption (which affects Lloyd’s underwriters) does not extend to investment income derived in the course of carrying on that insurance business from specified sources in New Zealand.
Chapter 820

Insurance Policies

820.10  Life insurance [s EY 8]

Life insurance is a contract to pay a certain sum of money on the death of a person, or on the happening of some specified event connected with the life of a person, such as the attaining of a stated age, in consideration of the payment of certain premiums. It is not a contract of indemnity. It is called an “aleatory contract” because it depends, as it were, on the throw of a die. The most common types of life insurance are:

(a) Whole of life, where the benefit under the policy is payable on the death of the person insured. Where these policies are “participating policies”, the policyholder is entitled to bonuses that add to the amount of the benefits payable under the policy;

(b) Endowment, where the benefit under the policy is payable on the insured attaining a certain age, or in the event of the prior death of the insured;

(c) Annuity, where the benefit under the policy is payable in the form of fixed periodical payments at regular intervals during the life of the annuitant or for a certain term;

(d) Double indemnity, which refers to a provision under an insurance policy under which the normal benefit is doubled if death occurs as the result of an accident;

(e) Term or temporary, where the insurance cover ceases after a certain time if death does not occur within that time, and there are no other benefits paid under the policy;

(f) Investment bonds which are either backed by equity assets or have capital guarantees; and

(g) Unlinked policies where the policyholder shares directly in the returns from an asset pool with no performance guarantee.

The premiums for the policies may be payable either:

(a) For the term of the whole policy;

(b) For a stated number of years; or

(c) In a lump sum at the commencement of the policy, in which case the policy is known as a “single premium policy”.

For income tax purposes, the term “life insurance” is defined in s EY 8 to mean insurance under which a life insurer, in return for a consideration, provides a policyholder with:

(a) A benefit contingent on the death of one or more human beings, including an annuity the term of which is contingent on human life;
Insurance Policies

820.15  Deductions for life and accident insurance premiums

To qualify as a deduction for income tax purposes, life and accident policy premiums must be paid by the taxpayer and the policy must be owned or be held for the benefit of the taxpayer and be part of some business transaction or arrangement with a purpose of producing income.

A distinction must be made between “permanent” life insurance policies and “temporary” life insurance policies. Temporary life insurance policies do not build up an asset, but provide life insurance cover for a stated period. Once the period of cover has expired, no claims can be made under the policy. Permanent life insurance policies, on the other hand, build up an asset, and therefore are generally regarded as capital expenditure in the form of an investment. In the latter cases, each premium is an addition to the investment, with the consequence that the premiums are not deductible.

The main types of business assurance are: partnership assurance; company-shareholder assurance; key employee assurance; and special purpose assurance.

820.20  Business assurance

(1)  Partnerships

Each partner owns a policy or an interest in a policy on the life of each of the other members of a partnership. The purpose is to provide cash on the death of any partner to enable the surviving partner or partners to purchase the deceased’s share of the business. It is not intended to produce income for the partners. With either temporary or permanent assurance, the premiums are not deductible and the proceeds are not assessable.

If the partnership owns the policies and pays the premiums, the long-term effect is to put additional funds into the partnership, and the premiums payable on the policies relate to the enlargement of the partnership’s income producing assets, and not to the production of the profits. They are, therefore, outgoings of a capital nature. The proceeds received under the policies are a capital receipt to the partnership. Amounts paid out from the insurance proceeds by the partnership to the deceased’s spouse, children, family trust, or estate are not deductible in arriving at the partnership profits.

(2)  Company shareholders

Each shareholder in a company owns a policy or an interest in a policy on the life of each of the other shareholders. The purpose is to provide cash on the death of any shareholder to enable the surviving shareholders to purchase the deceased’s shares in the company. It is not intended to produce income for the shareholders.
Insurance Policies

(3) **Key employees**

An employer owns a policy on the life of an employee who has special abilities or skills that contribute materially to the financial success of the employer’s business. The purpose is to provide cash on the death of a key employee to meet the cost of securing the services of a suitable replacement, or to replace the income that would be lost as a result of the employee’s death. It is intended to produce income for an employer. Premiums payable under a temporary assurance policy are deductible. Premiums payable under a permanent assurance policy are not deductible. The proceeds of both temporary and permanent assurance are assessable.

(4) **Special purpose**

An employer may own a policy on the life of an employee. If the employee’s death occurs the employer will receive the proceeds and will be free to deal with them in whatever manner thought fit. The proceeds could be used, for example, to repay a mortgage or a bank overdraft, pay for new plant or equipment, or as a deposit on a new property. If the employer wishes, it may be used to make a cash payment to the employee’s dependants.

If the employee remains in the service of the same employer until retiring age, and if an endowment or whole of life policy is used, the employer may use the proceeds to pay the employee an appropriate cash retiring allowance. This type of assurance is not usually intended to produce income for an employer. With temporary assurance the premiums may be deductible and, if so, the proceeds will be assessable. With permanent assurance, the premiums are not deductible and the proceeds are not assessable.

In *Williams's Executors v Inland Revenue Commissioners* (1944) 26 Tax Cas 23 and *Carapark Holdings Ltd v Federal Commissioner of Taxation* (1967) 115 CLR 653, (1967) 10 AITR 378 (HCA), life insurance policy proceeds were held assessable to the companies. The companies respectively had insured a director and a key executive.

820.25 **Employer-provided insurance**

(1) **Temporary, term, and accident and sickness policies**

The following rules apply generally to temporary or term life insurance and personal accident and sickness policies:

(a) Where proceeds are payable under the policy to the employee, and the employer has no beneficial interest in the policy:

(i) The premiums paid by the employer are deductible by the employer.

(ii) Except where the employee can convert the premium into cash (as where the employee is able to cancel the policy and obtain a refund of that part of the premium relating to the unexpired period of the insurance), the premium (or the share of it in group policies) is not assessable to the employee, but may be subject to fringe benefit tax.

(iii) Where the employee is able to convert the premium into cash (even if this is not done) the annual premium should be treated as an “extra pay” and taxed to the employee.

(iv) Lump sum payments received by the employee are not assessable, and weekly benefits and sick pay are exempt from tax unless calculated according to loss of earnings of the employee [s CW 34].

(b) Where proceeds are payable under the policy to the employer:

(i) The premiums paid by the employer are deductible and the proceeds are assessable.

(ii) Where the employer voluntarily makes payments to the employee’s dependants, such payments are generally not deductible to the employer, but where the employer is contractually bound to pay the proceeds to the employee’s dependants (eg as a condition of employment), the payments are normally deductible.
Insurance Policies

(iii) Weekly benefits for temporary incapacity (as distinct from lump sum benefits on death or permanent disablement) received by the employer and paid to the employee are taxable in the employee’s hands, and should have PAYE deducted in the normal way.

(2) **Endowment and whole-of-life policies**

The following rules generally apply to endowment and whole-of-life assurance policies:

(a) Where the employer has no beneficial interest in the policy and the employee has an indefeasible right to the proceeds:
   
   (i) The premiums paid by the employer are deductible; and
   
   (ii) The premium (or the portion applicable to each employee in a group scheme) is an “extra pay” and taxed to the employee; and

(b) Where the proceeds are payable to the employer:
   
   (i) No deduction is allowable to the employer for the premiums, as they represent capital expenditure by building up an asset; and
   
   (ii) The assessability of the proceeds depends upon the purpose for which the policy was taken out. If it was for investment, there would be no income tax liability when the policy matures. If it was taken out on the life of a key employee to compensate the employer for loss of profits, the employer would expect to suffer on the death of the employee through the loss of the employee’s services, the proceeds would be taxable. No deduction would be allowed for any part of the proceeds paid over to the deceased employee’s estate unless the employer was contractually bound to do so.

It is the CIR’s view that premiums paid for an endowment policy taken out for the purpose of repaying a business loan are not deductible under s DB 5. The premiums paid constitute the accumulation of a capital sum to repay the loan, they are not expenses incurred in borrowing money [see TIB vol 10:5 (May 1998) at 25].

820.30 **Mortgage repayment insurance**

Mortgage repayment insurance may be taken out to repay a mortgage if the taxpayer dies or is injured, or to cover mortgage payments during a period of incapacity by the taxpayer. The CIR regards premiums paid for mortgage repayment insurance as deductible under s DB 5, provided the money borrowed is used to produce (gross) income [see TIB vol 6:9 (February 1995) at 19-20].

820.35 **Insuring the life of a debtor**

It is not uncommon for a creditor to insure the life of a debtor where the amount of the debt is substantial. The premiums payable on such policy are not allowable as a deduction to the creditor. When all or any part of the debt becomes bad, a claim for a deduction of such amount may be made in the year actually written off.

Where a debtor effects a policy on his or her life for the purpose of offering as collateral security for advances etc, or where an existing life policy is assigned for this purpose, no deduction of the premiums is allowable to the debtor, even though the transaction may be in connection with the business operations. This viewpoint might change with particular types of life insurance policies.

Where a creditor accepts a life policy on a debtor’s life in payment of a debt and decides to maintain the policy by paying the annual premiums, the surrender value of the policy at the date accepted should be credited to the debtor’s account and the balance written off as a bad debt. No deduction is permissible for premiums paid in future years, nor is the amount ultimately realised under the policy liable to tax.

820.40 **Personal life insurance policies**

Bonuses allotted in life insurance policies, whether added to the policies and paid out on maturity date, or whether the surrender value is taken in cash, are not “income” of the policy holders as such bonuses represent a refund of part of the premium paid by the policy holder.
820.45 **Premiums paid under accident and sickness policies**

If premiums are incurred in the course of gaining or producing income they are deductible.

Loss of earnings policy premiums are deductible as they are incurred in maintaining a process to earn income. This applies irrespective of whether the policyholder is an employee or is self-employed. The restriction which precludes employees from claiming deductions does not apply because the premiums are not incurred in gaining or producing “income from employment”.

Personal sickness or accident policy premiums are not deductible as they are not incurred in maintaining a process to gain gross income.

An apportionment is necessary for premiums paid under most mixed policies which provide for both personal sickness and accident and loss of earnings benefits.

In a mixed policy, if the amount of a premium that is paid for the flat sum personal sickness or accident benefits is two per cent or less of the total premium, the CIR accepts that the whole of each premium can be deducted [see TIB vol 6:4 (October 1994) at 8-11].

820.50 **Compensation payments** [s CW 34]

The following payments received are exempt:

(a) Any amount derived by any person, for any period of incapacity for work, from any payment received by way of a benefit under a personal sickness or accident policy of insurance, which is not a payment calculated according to loss of earnings or profits. The following three components [see TIB vol 6:4 (October 1994) at 8-11] are necessary for it to be exempt:

(i) The amount is derived from a personal sickness or accident policy;

(ii) It is derived during a period of incapacity for work;

(iii) The amount is not calculated according to loss or earnings or profits.

(b) Amounts received from a friendly society or sick, accident or death benefit fund not being:

(i) Weekly compensation under the Accident Insurance Act 1998 of that is not recovered or recoverable;

(ii) A payment under a policy of personal accident or sickness insurance under s 188(1)(a) of the Accident Insurance Act 1998 before its repeal; or

(iii) Compensation for loss of earnings or loss of potential earning capacity from a work-related personal injury under the Accident Insurance Amendment Act 2000.

(c) Income derived by any person for any period of incapacity for work, or paid by a friendly society or paid from any sick, accident, or death benefit fund to which the person was a contributor at the date of the commencement of that period of incapacity.

820.55 **Annuities paid under a life policy** [s CW 4]

Annuities paid under life insurance policies offered or entered into in New Zealand by a life insurer, or offered or entered into outside New Zealand by a New Zealand resident life insurer, are exempt from tax.

820.60 **Amounts received under loss of profits policies** [s CG 5B]

From 4 September 2011, where a person receives a payment of insurance, indemnity or compensation for business interruption or impairment following an event, the timing of the derivation changes. To the extent to which the payment is attributable to a loss of income resulting from the event, derivation occurs at the earlier of the income year in which the payment is received or the income year in which the amount is reasonably able to be estimated.

Prior to this amendment, the timing of the derivation was governed by the principles established in *Egmont Co-operative Dairies Ltd (in liq) v Commissioner of Inland Revenue* (1996) 17 NZTC 12,536 (CA). In this case, an insurance payment received by a dairy company under its loss of profits policy was derived when the loss occurred, not when the payment was received.
Chapter 830
Interest

830.10 Interest assessable [s CC 4]
The effect of the definition of interest is that all returns to the lender, other than the loan capital repayments, are interest for income tax purposes. This would include any premium received by the lender.

“Interest” means a payment (other than a repayment or a redemption payment) made to the person by another person for money lent to any person, whether or not the payment is periodical and however it is described or calculated.

“Money lent” means [s YA 1]:
(a) An amount of money that a person lends in some way, including by depositing it in an account, whether or not the lending is secured or evidenced in writing;
(b) An amount of credit that a person gives, including by not enforcing a debt, whether or not the giving is secured or evidenced in writing;
(c) An amount of money that a person lends, or credit that a person gives, under an obligation or arrangement, whether or not secured or evidenced in writing;
(d) An amount of money that goes from a person (Person A) to another person (Person B) in consideration for Person B’s promise to pay Person A an amount of money and that is less than the amount that Person B promises to pay Person A.

TaxNote: Person B includes any other person with whom Person B is an associated.

Both use-of-money-interest payable by the CIR on overpaid tax and interest paid to an intermediary where the tax pooling system is used are subject to tax. When any securities have been acquired during the income year, any interest due or accruing due at the date of the transfer and not then paid is apportioned between the transferor and the transferee.

Foreign sourced interest derived while a person is a transitional resident is exempt [see 370.35].

830.15 Benefit from money advanced [s CC 7]
Income includes any benefits from money provided to a borrower for use in any business carried on in New Zealand by the borrower if the borrowing was a commercial transaction under which interest would have been payable at current commercial rates having regard to the nature and term of the loan if it were not for that benefit provided.

The value of the benefit is the amount of interest that the borrower would have been liable to pay had the loan been made on normal commercial terms.
This means that the value of the benefit or advantage of the free use of an asset for money advanced for use in a business in New Zealand is taxable, even when the benefit is not convertible into money. A parent who makes an interest-free advance to a relative or to a family trust, or an advance of a benefit in kind, is not liable to tax unless the money is employed by the borrower in a business in New Zealand. A member of a sporting club who advances money to the club in return for free membership is also not liable to tax. However, a scheme that allows residents living in a retirement village to make interest-free loans to the owner of the village in return for reductions in tenancy charges could be assessable [see PIB 164 (August 1987)].

830.20 Interest from debentures [ss FA 2, DB 10]
Debentures which are a “profit-related debenture” are treated as shares for tax purposes [see 830.40]. The interest received by the debenture holder is treated as a dividend. No deduction may be claimed by the company for any expenditure or loss incurred in connection with the debenture or in borrowing the money secured by or owing under the debenture.

830.25 Interest compounded [s BD 3(4)]
In some debenture stock issues, investors are given the option of allowing the interest to be compounded and uplifted on maturity of the stock. Some bank term deposits also provide for annual interest to be added to the investment and attract additional interest in subsequent years. Interest must be returned year by year. This section states that income is deemed to be derived when it is credited in account, or dealt with in the person’s interest or on their behalf.

830.30 Life insurance proceeds
The Court of Appeal in Marac Life Assurance Ltd v Commissioner of Inland Revenue (1986) 8 NZTC 5,086 (CA) held that “gains” received by a holder of a life bond were to be treated as tax-free capital payments as the bonds were in the nature of life insurance contracts.

830.35 Interest from inflation-indexed instruments [s EI 2]
The purpose of s EI 2 is to impose income tax annually (rather than only on a payments basis), on the holders of inflation-indexed debt instruments for any inflation-linked amounts. It applies when:
(a) An amount of money lent is outstanding at the end of an income year; and
(b) In a future income year an amount is payable which is determined by a fixed relationship to one or more indices of general price inflation in New Zealand.

When, at the end of an income year, there is an increase between the indexed amount accrued and the indexed amount (if any) accrued either at the time of lending (if the money was lent during the current income year), or at the end of the previous income year (in any other case), it is treated as having been credited in account and capitalised by the borrower for the benefit of the lender on the day following the day on which the level of the relevant index at the end of the current income year becomes public knowledge.

This does not apply when, on account of the increase, an amount has previously been paid to the lender or credited to the lender or otherwise dealt with in the lender’s interest, or when the money lent has previously been repaid. It also does not apply to deem an increase in the accrued indexed amount when, over a previous income year, there was a decrease and the increase simply represents a recovery of that decrease. If the level of the relevant index is not calculated as at the end of any income year, these rules apply as if the date most closely preceding the end of the income year on which the level was calculated were substituted for the end of the income year.

830.40 Deductible interest — companies [ss DB 1(1), DB 7, DB 8, DB 10, DB 10B, FA 2, FA 2B]
Companies are generally allowed a deduction for interest incurred without the need to establish a nexus with the derivation of assessable or excluded income. However, there are a number of exceptions to this rule:
(a) The automatic deduction does not apply to qualifying companies.
Interest

(b) Automatic deductibility is denied to companies where the company or another company in the same wholly-owned group derives exempt income other than:

(i) Dividends;
(ii) Income that is exempt under s CW 58 (Disposal of company’s own shares); or
(iii) Income that is exempted under s CW 60 (Stake money) and is ancillary to the company’s business of bloodstock breeding.

(c) New Zealand resident companies with an income interest of 10 per cent or greater in a controlled foreign company are subject to interest allocation rules to prevent excess interest deductions being claimed in New Zealand [see 830.43].

(d) The automatic deduction applies to non-resident companies only in respect of interest incurred in the course of carrying on a business through a fixed establishment in New Zealand.

(e) The automatic deduction does not apply to interest which is payable under the laws of a foreign country and which is substantially the same as a civil penalty as defined in s 3 of the TAA.

(f) Debentures which are a “profit-related debenture” are treated as shares for tax purposes [s FA 2]. No deduction may be claimed by the company for any expenditure or loss incurred in connection with the debenture or in borrowing the money secured by or owing under the debenture. A “profit-related debenture” is a debenture with a rate of interest that is determined from time to time by reference to a dividend payable by the issuing company or by the profits of that company. The term does not include a debenture under which the interest is calculated by way of a fixed relationship to banking or commercial interest rates, or economic, commodity, industrial or financial indices. Neither does it include a debenture that is treated as a share under s FA 2B, which relates to staples debt securities.

(g) Where a company has issued debentures to its shareholders in substitution for shares (substituting debentures), the interest paid by the company is not allowable as a deduction to the paying company and is treated as a dividend in the hands of the shareholder [s DB 10]. A substituting debenture is a debenture where the amount of the debenture is determined by the number of shares held by the shareholder, the available subscribed capital of the company or any other reference to shares whether in that company or another company. The tests apply whether or not the company has been liquidated and whether or not the shareholder currently holds the shares. The term does not include a debenture that is a convertible note. Nor does it include a debenture that is treated as a share under s FA 2B, which relates to staples debt securities.

(h) Where a company has issued a stapled debt security which is stapled to a share in the company or to a share in another company and the share is not a fixed-rate share, no deduction is allowed for interest payable under the security, any expenditure or loss incurred in connection with the security, or any expenditure or loss incurred in borrowing the money secured by (or owing under), the security [s DB 10B]. For the purposes of this provision, a debt security is “stapled” to a share if it can, ordinarily, be disposed of only together with the share and the company which issued the debt security is a party to that arrangement. The term does not include a debt security which is stapled to a share using a shareholder agreement for a company that is not a widely held company [s FA 2B].

Companies are allowed a deduction for interest incurred on money borrowed to acquire shares in another company within the same group of companies. This deduction is denied if the companies are not in the same group at the end of the tax year for which the deduction is claimed. However, the deduction remains available when the company whose shares were acquired with the borrowed funds has ceased to exist on a qualifying amalgamation provided that the two companies were in the same group of companies immediately prior to the amalgamation. The grouping requirements are set out in s IC 3.

The expression “to acquire shares” should be given its plain and ordinary meaning. The deduction is available irrespective of the form of acquisition. For example, if the shares are obtained by subscription the deduction is not precluded. The deduction is allowed not only on the original acquisition of shares, but also where the shares were issued at an earlier date, but the company has not previously provided all consideration for those
shares, or where the borrowings to acquire shares has been refinanced. It should also be noted that expenditure
deemed to be incurred under a financial arrangement is also deemed to be interest.
Where the automatic deductibility of interest is not granted by ss DB 7 or DB 8, a company may still achieve
a deduction under the interest deductibility rules contained in s DB 6.

830.43  Interest apportionment rules when shares held in controlled
foreign company [subpart FE]

Editorial Note
At the time of publication of the Staples Tax Guide 2012, 72nd edition, the Taxation (International Investment and Remedial
Matters) Bill had not been passed into law. It is anticipated that the content of this paragraph will be changed following the
passing of the Bill. For an overview of the changes contained in the Bill, please refer to the “Future Developments” section of
this book.
When enacted, these changes will also be available in the Staples Tax Guide online at www.brookersonline.co.nz. The changes
will also be included in the Staples Tax Guide 2012 - Mid-Year Supplement.

With the change to the controlled foreign company (CFC) rules to tax only passive income of the CFC when
the active income test is failed, much of the income derived by CFCs remains outside the New Zealand tax
base. Dividends from CFCs are also now fully exempt in that the FDP rules will no longer apply.
To ensure excess interest deductions are not claimed in New Zealand against income from other sources, the
existing thin capitalisation rules in subpart FE have been extended for income years beginning on or after
1 July 2009 so that they also apply to outbound entities — being New Zealand residents with income interests
in a CFC of 10 per cent or greater.
The rules are referred to as the interest allocation rules, and like the existing thin capitalisation rules focus
on the debt levels of the New Zealand entity. A principal difference being that the focus of the thin
capitalisation rules is on New Zealand residents controlled by a non-resident (inbound investment), the focus
of the interest allocation rules is on residents that control a non-resident (outbound investment). Colloquially,
the rules are also referred to as the “fat capitalisation” rules as in effect they guard against New Zealand
residents over capitalising their CFCs and retaining the debt in New Zealand.

TaxNote: While these rules target people with an income interest of 10 per cent or greater in a CFC [see
paragraph (b) of “income interest” definition in s YA 1], once the rules apply, they apply to all financing
costs (as defined in s FE 6) of the New Zealand entity not just those used to acquire the interest in the CFC
(s).
The interest allocation rules build on the existing thin capitalisation rules in subpart FE. The existing safe
harbours apply. Interest deductions are not restricted unless the New Zealand group debt percentage is more
than 60 per cent (and, for a company or a trustee, is also more than 110 per cent of the worldwide group debt
percentage).
An outbound entity will not typically be required to apportion interest expenditure unless New Zealand group
assets are less than 90 per cent of the assets of the worldwide group and the total interest deductions of the
New Zealand group are more than $250,000. In addition, there is an adjustment mechanism for outbound
entities with finance costs of less than $2 million. This eliminates apportionment for outbound entities with
finance costs of up to $1 million and provides tapered relief for those with finance costs between $1 million
and $2 million.
Various changes have been made to the definitions of “debt” and “assets” in subpart FE. Fixed-rate foreign
equity and fixed-rate shares held by New Zealand residents are now included when determining total group
debt for the New Zealand group. Equity investments in CFCs are no longer included within the total group
assets of the New Zealand group. The rules for measuring the debt of the worldwide group have been aligned
with those for measuring the debt of the New Zealand group.
Sections FE 1 and FE 2 have been amended to ensure that the existing interest apportionment rules now apply
to New Zealand residents who have income interests in a CFC (referred to as the outbound entity) or who
control a New Zealand company with an income interest in a CFC.
The safe harbour rules set out in s FE 5 now apply to outbound entities as well as to entities controlled by non-residents. Thus, an outbound entity will not be subject to restriction of its interest deductions under subpart FE unless it has a New Zealand group debt percentage that is more than 60 per cent (and, for a company or a trustee, is also more than 110 per cent of the worldwide group debt percentage).

Additional carve-outs apply to outbound entities by virtue of s FE 5(1B). There is an exemption from the requirement to apportion interest expenditure when:

(a) The value of New Zealand group assets (measured under s FE 16) is 90 per cent or more of the value of the assets of the worldwide group (measured under s FE 18); or

(b) Total interest deductions of the New Zealand group allowed under ss DB 6 to DB 8 are not more than $250,000 (net of total deductions allowed in relation to interest payable intra-group) and the group does not include an entity with an income interest in a CFC that derives rent from land in the country or territory in which the CFC is resident.

Section FE 6 contains the formula for apportioning interest for an excess debt entity. The effect of the formula, when it applies, is to produce an additional amount of income for the entity that offsets the interest deduction. As well as interest, the formula now includes in ss FE 6(2) and FE 6(3(ab) dividends paid in relation to fixed-rate foreign equity or fixed-rate shares.

For outbound entities with finance costs of between $1 million and $2 million, the amount of the total deductions and FRD in the formula in s FE 6 is reduced by an amount calculated by subtracting the finance costs from $2 million. Thus, if the finance costs are $1.25 million, the item “adjust” will be $750,000. Thus, the item gradually reduces as financing costs increase to $2 million.

Various amendments have been made to the definitions of debt and assets in subpart FE. In particular:

(a) Fixed-rate foreign equity and fixed-rate shares held by New Zealand residents are included when determining total group debt for the New Zealand group under s FE 15.

(b) Equity investments in CFCs are excluded when determining total group assets for the New Zealand group under s FE 16.

(c) The rules in s FE 18 for measuring the debt of the worldwide group have been aligned with those for measuring New Zealand group debt. Accordingly, non-interest bearing liabilities and liabilities that do not provide funds are no longer treated as debt for the worldwide group, even if they are included as debt under generally accepted accounting practice.

Otherwise the normal rules in subpart FE that relate to measuring total group debt and assets apply, in particular, the New Zealand group debt percentage can be measured on various dates as set out in s FE 8 and the various bases in s FE 16 for the valuation of total group assets may also be used. Also the on-lending concession under s FE 13 applies to arm’s-length debt provided by an outbound entity to its CFCs.

As with the rules for inbound debt, the outbound debt rules require the New Zealand group to be established. This is done by first establishing the New Zealand parent. The New Zealand parent is identified under s FE 26(4B) by tracing ownership interests up the chain of companies on a tier-by-tier basis until no New Zealand-resident company has an ownership interest of 50 per cent or more in the last company in the chain. The New Zealand group comprises those companies for which control can be traced from the parent [s FE 28]. The meaning of “control” for these purposes is determined under s FE 27. If there is a natural person or trustee (described in s FE 2(10(g)) that has a 50 per cent or more ownership interest in a member of a New Zealand group that has a member that is an excess debt outbound company, and that natural person or trustee also has a 50 per cent or more ownership interest in another New Zealand group that has a member that is an excess debt outbound company, those groups are to combine to form one New Zealand group.

For an outbound entity that is an individual or a trustee, the New Zealand group is determined under s FE 3(2). It includes all associated persons who are residents or have a fixed establishment in New Zealand or who derive New Zealand-sourced income that is not relieved under a double tax agreement. Excess debt outbound companies, and those within the New Zealand group of such companies, are not included.
For the purposes of calculating the worldwide group debt percentage for excess debt outbound companies the rules in ss FE 31B and FE 32 apply. This includes the company, its New Zealand group, and its worldwide GAAP group (being all non-residents required to be included with the company in consolidated financial statements under generally accepted accounting practice). Under s FE 31C, if a natural person or trustee has a 50 per cent or more ownership interest in an excess debt outbound company that is a member of a world wide group, and also an income interest in a CFC that is not part of that worldwide group, the CFC is deemed to be a part of that group.

For a trustee, the worldwide group is determined under s FE 3 and includes the trustee, the trustee’s New Zealand group, and all CFCs in which either the trustee or another member of the New Zealand group has an income interest.

**830.45 Deductible interest — other** [ss DB 1(1), DB 6, subpart FE]

Interest incurred by non-companies, and by companies whose interest expense does not qualify for the automatic deductibility under ss DB 7 and DB 8 (see above) is subject to the normal rules of deductibility contained in the general permission. The deductibility is subject to all of the general limitations other than the capital limitation. No deduction is permitted in respect of interest which is payable under the laws of a foreign country and which is substantially the same as a civil penalty as defined in s 3 of the TAA.

**TaxNote:** For individuals and trustees of trusts settled by New Zealand residents, interest deductibility on money borrowed to purchase shares in a controlled foreign company may be affected by the rules in subpart FE [see 830.43].

When money is borrowed, it is the use to which those funds are put which determines the deductibility of any interest payable. There must be sufficient nexus between the interest expense and the derivation of assessable and/or excluded income.

The interest is deductible when:

(a) The related capital is used in the period in which the deduction is claimed to derive income in any tax year or equivalent income year; and

(b) No identifiable part of that capital is used for the whole or part of that period in other ways (such as private or domestic use, or a use that produces exempt income).

The interest is not fully deductible if part of the capital is used for a private or domestic use or a use that is incapable of deriving income in the period for which the deduction is claimed or in the future. In this case, only the portion of the interest that relates to the income producing purpose is deductible.

The onus is on the taxpayer to establish the degree to which the capital is used in the period in question in deriving income. The taxpayer must show the factual basis of the claim. If that onus is discharged, the entire amount of interest is deductible. Whether or not the taxpayer’s evidence discharges that onus is a matter of degree and a question of fact.

Section DA 1(1)(b) allows a deduction for interest incurred in carrying on a business for the purpose of deriving assessable and/or excluded income. It applies only to taxpayers in business. This provision allows additional deductions for taxpayers in business, since it covers interest that may not be able to be shown as actually deriving assessable and/or excluded income.

It is not essential that the income be derived in the same income year as that in which the deduction is claimed. It is necessary only that the interest relates to the derivation of assessable and/or excluded income for any income year.

Where interest is incurred to retain assets that are used in deriving assessable and/or excluded income, the interest is deductible provided that the taxpayer establishes that the capital was borrowed to meet involuntary expenditure to retain the assets. This principle was established in *Public Trustee v Commissioner of Taxes* [1938] NZLR 436 (CA) and applied in *Williams v Commissioner of Inland Revenue* (1988) 10 NZTC 5,078 (HC) and *Borlase v Commissioner of Inland Revenue* (2001) 20 NZTC 17,261 (HC). However, if the capital was borrowed for a different purpose, the interest is not deductible.
Where the interest expenditure is incurred to retain some assets that derive gross income and some which do not, it must be apportioned. The onus is on the taxpayer to establish that the interest is deductible, and what proportion of it is deductible.

The CIR has issued an interpretation statement analysing the principles of the Public Trustee case [see TIB vol 18:6 (July 2006) at 9-27]. The CIR considers interest will be deductible where:

(a) The liability that the borrowed funds were used to discharge was involuntary;
(b) The taxpayer definitely would have realised particular income earning assets if the taxpayer had not borrowed; and
(c) The liability that the borrowed funds were used to discharge arose in connection with the income earning assets retained.

**TaxNote:** The second and third conditions may give rise the necessity to apportion between business and non-business purposes. Where all three conditions are met, the taxpayer will be entitled to a deduction. However, it may be possible for a valid claim to be established where one or more of the conditions is not met.

Expenditure deemed to be incurred under financial arrangements is deemed to be interest payable. However, certain financial arrangements, which give rise to deemed interest expenditure, do not have any underlying capital (eg interest rate swaps). In these situations, the use of borrowed capital cannot determine whether the interest is deductible. Whether or not the interest is deductible, is a matter of degree and a question of fact. In all cases the focus of the inquiry is on whether there is sufficient relationship between the expenditure and the income earning process of the taxpayer claiming the deduction: Commissioner of Inland Revenue v Banks [1978] 2 NZLR 472, (1978) 3 NZTC 61,236, (1978) 2 TRNZ 323 (CA).

**Example 1:**
An individual borrows $10,000 at 10 per cent per annum to finance a purchase of shares in a company. No dividend is paid in the five income years following the purchase of the shares but the taxpayer pays interest on the loan in each of the five income years. The individual can deduct the interest in full in each of the five income years because the capital is used in each year in deriving income. Even though the company paid no dividends, the interest is deductible provided that the company has no restriction in its constitution preventing the payment of dividends in the future. The interest is deductible provided that the shares are expected to earn income. There is no requirement that income be derived in the year in which the interest deduction is claimed.

**Example 2:**
A taxpayer borrows a substantial amount of money and uses it to buy a house for investment as part of a retirement plan. The house is rented at a market rental but the interest exceeds the rental income earned. The interest is fully deductible in every year in which the property is let or is available for letting. The taxpayer’s possible intention to make a capital gain from the house does not affect the deductibility.

**Example 3:**
In a particular income year a self-employed taxpayer uses part of her home as an office in connection with her business. She has a mortgage on the house. There are two competing uses present: a private use and an income-earning use. The mortgage interest is deductible to the extent to which it is payable in deriving assessable and/or excluded income. There must be an apportionment between the two uses. In this situation, the CIR would generally accept apportionment on a floor area basis.

**Example 4:**
A New Zealand importer of sport shoes buys shoes from the US to sell in New Zealand. The importer pays for the shoes in US dollars, and then hedges the obligation to pay US dollars by a forward foreign exchange contract. This contract later results in a foreign exchange loss. The exchange loss is deemed to be interest and is deductible as it has a sufficient nexus with the taxpayer’s income earning process.

**Example 5:**
A taxpayer who is in business has insufficient funds to pay his tax. Rather than realise assets which derive gross income, he borrows money to make the payment. The interest is fully deductible as it is payable in carrying on a business for the purpose of deriving assessable and/or excluded income. The interest is payable in preserving assets required for the business of the taxpayer.
Interest

Example 6:
An individual, who is not in business, has an end of year tax liability and borrows to pay the tax. The individual’s assets comprise a house and a car. The interest is not deductible because there is no nexus with deriving income. If the same taxpayer has investments in government stock and, rather than realising the investments, borrows to meet the tax expenditure, the interest would be deductible to the extent to which it is payable in meeting an involuntary tax expenditure and to preserve income producing assets. To the extent to which the interest is paid to preserve non-income producing assets, it is not deductible. The method of apportionment of the interest depends on the facts of each case.

Example 7:
A taxpayer decides to buy a house to live in. She could finance the purchase by realising her income producing investments but instead she decides to borrow to finance the purchase. The interest is not deductible as the borrowed funds are not used in deriving assessable and/or excluded income. The expenditure is of a private or domestic nature.

Example 8:
A sole trader borrows to buy a luxury car for personal use rather than realise business assets to meet the cost of the car. The interest is not deductible as there is no nexus with the income earning process. The interest is not payable in deriving assessable and/or excluded income, nor is it payable in carrying on a business for that purpose. The expenditure is of a private or domestic nature.

The CIR has issued Public Binding Rulings 10/14 to 10/19 set out the CIR’s view on the deductibility of interest incurred on funds borrowed to repay and replace an amount which was previously invested in an income earning activity or business.

Ruling BR Pub 10/14 relates to funds borrowed by a partnership to return capital contributions to partners. In order for the ruling to apply, the partnership must be carrying on business for the purpose of earning assessable and/or excluded income both at the time at which the partnership borrows the funds and the time at which the interest on those borrowed funds is payable. In addition, the interest payable must be at an arms-length interest rate. The ruling provides that a partner’s share of the interest will be deductible to the extent to which that partner’s capital contribution was used directly in the partnership business or used to repay borrowed funds on which the interest was deductible. Interest on the funds borrowed to repay partner’s capital contributions will not be deductible to the extent to which the funds are used to pay current year income to the partner or to make a distribution of unrealised gains from asset revaluations or internally generated goodwill.

Ruling BR Pub 10/15 relates to the deductibility of interest paid on funds borrowed by a partnership to fund the return of profits to partners. In order for the ruling to apply, the partnership must be carrying on business for the purpose of earning assessable and/or excluded income both at the time at which the partnership borrows the funds and the time at which the interest on those borrowed funds is payable. In addition, the interest payable must be at an arms-length interest rate. The ruling provides that a partner’s share of the interest will be deductible to the extent to which the profits that are being distributed are past years’ profits that have been used directly in the partnership business or used to repay borrowed funds on which the interest was deductible. Interest will not be deductible to the extent to which the funds are used to pay current year income to the partner or to make a distribution of unrealised gains from asset revaluations or internally generated goodwill.

Ruling BR Pub 10/16 relates to the deductibility of interest paid on funds borrowed by a company to repurchase shares. In order for the ruling to apply, the company must be carrying on an activity or business for the purpose of earning assessable and/or excluded income both at the time at which the partnership borrows the funds and the time at which the interest on those borrowed funds is payable. In addition, the interest payable must be at an arms-length interest rate. The ruling provides that the interest will be deductible to the extent to which the funds are used to repurchase shares which were funded by shareholder contributions or past years’ profits that have been used directly in the company’s income-earning activity or business or used to repay borrowed funds on which the interest was deductible. Interest will not be deductible to the extent to which the funds are used to pay current year income to shareholders or to make a distribution of unrealised gains from asset revaluations or internally generated goodwill.

Ruling BR Pub 10/17 relates to the deductibility of interest paid on funds borrowed by a company to pay dividends to its shareholders. In order for the ruling to apply, the company must be carrying on an activity...
or business for the purpose of earning assessable and/or excluded income both at the time at which the partnership borrows the funds and the time at which the interest on those borrowed funds is payable. In addition, the interest payable must be at an arms-length interest rate. The ruling provides that the interest will be deductible to the extent to which the dividends are funded by past years’ profits or capital contributed by the shareholders and have been used directly in the company’s income-earning activity or business or used to repay borrowed funds on which the interest was deductible. Interest will not be deductible to the extent to which the funds are used to pay current year income to shareholders or to make a distribution of unrealised gains from asset revaluations or internally generated goodwill.

Ruling BR Pub 10/18 relates to the deductibility of interest paid on funds borrowed to repay debt. The ruling applies to a taxpayer or partnership carrying on an activity or business for the purpose of deriving assessable and/or excluded income both at the time at which the funds are borrowed and the time at which the interest on those borrowed funds is payable. In addition, the interest payable must be at an arms-length interest rate. The ruling provides that the interest will be deductible to the extent to which the funds that are repaid were:

• Used directly in the income-earning activity or business;
• Used by a company and the interest on those repaid funds was deductible under s DB 7 of the Act;
• Used by a company to repurchase shares and the interest on those repaid funds was deductible under s DB 7 of the Act;
• Used for an arrangement covered under any of the above four rulings (BR Pub 10/14 to 10/17) and met the test for deductibility contained in those rulings;
• Used to retain income-earning assets and satisfied the elements in Public Trustee v Commissioner of Taxes [1938] NZLR 436 (CA) (see above); or
• Themselves were used to repay borrowings in respect of which the interest was deductible.

Ruling BR Pub 10/19 relates to the deductibility of interest paid on funds borrowed by a company to make a payment to a group company that has a loss where the payment is made under s IC 5 of the Act (ie a subvention payment). The ruling provides that the interest will not be deductible.

None of the above rulings applies to companies in respect of interest which is deductible under s DB 7 [see 830.40]. Neither do they apply to avoidance arrangements. All of the rulings are subject to the thin capitalisation rules in subpart FE of the Act see 1000.85]. The rulings, all of which apply from 23 May 2010 to 23 May 2015, can be viewed in full on the Inland Revenue’s website www.ird.govt.nz.

830.50 Borrowing to purchase shares granting right of occupancy of business premises

Shares may guarantee the occupation of premises, such as in the case of flat owning companies, or provide premises from which to run a business. Usually, under the terms of the tenancy agreement, shareholders pay only a nominal rent plus a monthly levy to cover outgoings on the buildings. The company in these circumstances rarely pays a dividend. It has been claimed, in this type of transaction where the premises are used for business purposes, that the shares are not purchased as an investment but for the purposes of securing continued occupation of the premises, thus enabling the taxpayer to carry on business. As a general principle, where interest is paid on money borrowed to purchase shares and the primary right attaching to the shareholders is a right of occupancy of premises used in deriving income, the interest will be regarded as payable in carrying on business for the purpose of deriving income.

830.55 Case law

In TRA Case H10 (1986) 8 NZTC 160, the TRA held that there must be a direct and not an indirect link between the expenditure and the income earning process. Where a husband and wife received a legacy sufficient to repay three mortgages on their private dwelling but only repaid two, investing the balance, they could not claim deduction of mortgage interest on the grounds that the interest was incurred to produce the investment income.
In *TRA Case H2* (1986) 8 NZTC 105, the TRA held that, where a loan was raised to purchase a vehicle for business use and 80 per cent of the total use was business use, deductions for 80 per cent of interest paid were reasonable.

In *TRA Case H88* (1986) 8 NZTC 607, the taxpayer borrowed $370,000 to finance erection of building Y. The advance was subsequently refinanced as part of restructuring. The taxpayer then moved to premises Z and later sold premises Y. The TRA held that, when operations ceased at Y and no rent or interest was received from it, Y ceased to be employed in deriving income and the interest on the borrowings ceased to be deductible.

In *TRA Case M127* (1990) 12 NZTC 2,817, the interest associated with the finance raised to purchase a house was not deductible. The taxpayers had capital in their business but, if it was withdrawn, the business would need to either sell or borrow. The loan documents included a statement making reference that the purpose of the loan was to purchase a house.

In *Case 29* 4 NZTBR, the taxpayer and his wife put their house on the market but were unable to find a buyer at the time, and decided to lease it to a tenant with an option to purchase. They then bought another house and financed the purchase with a temporary overdraft. As the lessee of the first property declined to exercise his option, the taxpayer had to raise a first mortgage secured against both properties to repay the overdraft. The taxpayer claimed a deduction for his share of the interest on the temporary finance and mortgage, but the CIR rejected his claim on the ground that the raising of the mortgage was related to the purchase of the new home, which was not income-producing. The Taxation Board of Review agreed with this view. It is not enough merely to have a mortgage secured over an asset that produces income if the borrowed money is not in fact used in producing income.

In *TRA Case E12* (1981) 5 NZTC 59,069, (1981) 4 TRNZ 364, the taxpayer sold a motel and left part of the purchase price on mortgage to the buyer. It was agreed by the taxpayer and his mother-in-law that $12,000 of the profit on the sale of the motel was her share. The sum remained in the taxpayer’s hands interest-free and unsecured. The taxpayer purchased a home and subsequently the mother-in-law also bought a home. The taxpayer raised $16,000 to assist in the purchase of her home, secured by a mortgage over both properties. The taxpayer claimed a deduction of the interest on the $16,000 against the mortgage interest received from the motel. The CIR disallowed the deduction. The TRA held, that on completion of the sale of the motel, the business was wound up leaving only the taxpayer’s personal commitment to honour a verbal agreement to pay his mother-in-law part of the sale profits. The purpose of the $16,000 mortgage was to provide a home for her and the interest payable was not capital employed in deriving gross income.

In *TRA Case F41* (1983) 6 NZTC 59,767, a taxpayer sought to deduct interest on moneys borrowed to settle residual business debts that arose through the failure of a business. The TRA held that interest is only deductible on capital employed for the purpose of deriving gross income at the time the interest is paid. In this case, as the business had already failed, there would be no future income against which to offset the interest. Accordingly, the taxpayer’s claim was disallowed. See also *TRA Case J25* (1987) 9 NZTC 1,148.

In *Commissioner of Inland Revenue v Brierley* [1990] 3 NZLR 303, (1990) 12 NZTC 7,184 (CA), the taxpayer subscribed for additional shares in Brierley Investments Ltd and funded the purchase by way of substantial borrowings. Assessable dividends were paid from the revenue reserves in one year only. The Court followed its decisions in *Pacific Rendezvous Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 567, (1986) 8 NZTC 5,146 (CA) and *Eggers v Commissioner of Inland Revenue* [1988] 2 NZLR 365, (1988) 10 NZTC 5,153 (CA) and examined whether the borrowed money was fully employed in deriving income in that income year or future income years. If no identifiable part is employed for the whole or part of the year in other ways, the statutory test is met.

In *Federal Commissioner of Taxation v Total Holdings (Aust) Pty Ltd* (1979) 9 ATR 885, 79 ATC 4279 (FCA) and *Ure v Federal Commissioner of Taxation* (1981) 11 ATR 484, 81 ATC 4100 (FCA), the Federal Court of Australia considered the question of the quantum of interest allowed as a deduction where moneys borrowed are on-lent at a lower interest rate. In *Ure*, the deduction was limited to the lower interest rate at which moneys were on-lent because the predominant object of the taxpayer was a private and domestic
advantage. In Total Holdings, the deduction was allowed at the higher borrowing rate, the making of interest free loans being relevant to the derivation of income by the taxpayer.

In Begg v Deputy Commissioner of Taxation (1937) 1 AITR 78 (SASC), it was held that interest on unpaid legacies is not deductible against estate income as it is not an expense in earning income.

In Pacific Rendezvous Ltd v Commissioner of Inland Revenue [1986] 2 NZLR 567, (1986) 8 NZTC 5,146 (CA), the taxpayer company borrowed money to develop a motel complex for selling individual units on a unit title basis in 1976. The sale of the units was protracted and the CIR disallowed deductions for interest on borrowed funds over two of the seven relevant income years. The Court of Appeal held that the apportionment was inapplicable. The interest claimed had been paid on capital employed in the production of assessable income and was thus deductible. The fact that it could be said that the borrowed money was also employed for another reason (obtaining a capital gain) was held to be irrelevant.

In Stevens v Commissioner of Inland Revenue (1989) 11 NZTC 6,001 (HC), TRA Case J10 (1987) 9 NZTC 1,055 was applied. The High Court held that it was irrelevant to the deduction of interest in one income year that the investment had ceased to be profitable and that income was only produced in some income years.

In Federal Commissioner of Taxation v Jones [2001] FCA 1153, (2001) 47 ATR 638, the Federal Court of Australia held that interest incurred on a business was deductible notwithstanding that the business had ceased. The Court held that neither the cessation of the business, a change in the identity of lender, nor the passage of time broke the nexus between the expense incurred and the earning of business income. It is not known whether the New Zealand Courts will follow the reasoning of the Australian Court in this regard.
### Chapter 850
#### International Tax Regime

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New Zealand’s international tax regime is comprised of three essential components:

850.05 General overview

New Zealand’s international tax regime is comprised of three essential components:
International Tax Regime

(a) A tax regime for controlled foreign companies (CFCs) [see 850.10 to 850.125];
(b) The foreign investment fund (FIF) rules for non-controlled foreign entities [see 850.130 to 850.290];
(c) The rules for foreign and non-complying trusts [see 1420 TRUSTS AND ESTATES].

Leaving aside the rules for foreign and non-complying trusts [see 1420 TRUSTS AND ESTATES], New Zealand’s international tax rules have undergone significant change in recent times:
(a) The FIF rules [see 850.130 to 850.290] were extensively rewritten from the 2007-2008 tax year;
(b) The CFC rules [see 850.10 to 850.125] have been extensively rewritten to exempt active income from the 2010-2011 income year; and
(c) Foreign dividends are (from the 2010-2011 income year) generally exempt.

With the decision to exempt most foreign dividends, the foreign dividend withholding payment rules [see 670.120], underlying foreign tax credit rules [see 670.230] and the branch-equivalent tax rules [see 670.285] are being phased out. The conduit tax rules [see 215 CONDUIT TAX RELIEF] are also being phased out with the changes to exclude active CFC from being taxable in New Zealand.

The international tax changes apply generally from the 2010-2011 income year. However, taxpayers with balance dates on or after 30 June 2009 can apply the new rules from the 2009-2010 income year. Thus, many of the changes have been made for income years beginning on or after 1 July 2009 to accommodate people with late 2009 balance dates that elect to use the new CFC rules for their 2009-2010 income year.

**Example:**
Company A has a standard 31 March income year. For Company A’s income year commencing 1 April 2009, Company A will apply the old CFC rules. Company B has a 30 September balance date. The new CFC rules will apply for the income year commencing 1 October 2009.

850.10 Controlled foreign companies [ss CQ 1, CQ 2, CQ 3, EX 1 to EX 27]

New Zealand taxes on the principles of residence and source. The income derived by a non-resident company from foreign sources is outside the tax jurisdiction of New Zealand, even if the foreign company is owned by New Zealand residents [s BD 1(4)]. However, when the foreign company is “controlled” by New Zealand residents (ie it is a controlled foreign company), New Zealand’s CFC rules may apply to the New Zealand shareholders in respect of their income interest in the CFC to attribute CFC income to the resident shareholder.

Under the CFC rules that applied until the 2010-2011 income year (or until the 2009-2010 income year for taxpayers with balance dates on or after 30 June 2009), New Zealand taxed resident shareholders of CFCs on their share of all income of the CFC. A credit was provided for tax paid by the CFC. Dividends were also taxed under the foreign dividend withholding payment rules with credits allowed for any underlying foreign tax paid.

The key exceptions were if the foreign company was resident in one of eight grey-list countries, or if the conduit exemption applied. If the foreign company was resident in a grey-list country, its New Zealand shareholders were not required to attribute income under the CFC rules. Conduit tax relief reduced tax payable under the CFC rules and on dividends from the CFC to the extent the extent the CFC was owned by a New Zealand company with non-resident shareholders.

New Zealand companies receiving foreign dividends were required to make a foreign dividend withholding payment (FDP). Credits were available against the FDP liability for foreign withholding taxes on the dividend. For non-portfolio dividends, foreign taxes on the underlying company profits were available. A company receiving a non-portfolio dividend from a grey-list country qualified for a deemed underlying foreign tax credit equal to its FDP liability on the dividend. Credits were also available under the branch equivalent tax account (BETA) mechanism to prevent double New Zealand taxation under the CFC and FDP rules.

The central features of the new rules are an active income exemption for the active income of CFCs, and an exemption for most foreign dividends received by New Zealand companies. Interest allocation rules (also known as fat capitalisation rules) are a feature of the new rules. These ensure New Zealand residents do not
over capitalise CFCs at the expense of the New Zealand tax base. The fat capitalisation rules place an upper limit on the amount of interest that can be claimed as a deduction in New Zealand.

The active income exemption now means that only passive income will be attributed back to the New Zealand shareholders of a CFC. Passive income will not be attributed when it is less than five per cent of the gross CFC income or when the CFC is resident in Australia. As with the FIF rule changes that took affect from the 2007-2008 income year, the grey-list of exempt countries has been removed.

A CFC is a foreign company (with certain qualifications) that is controlled by resident shareholders, who do not necessarily need to be individuals. The CFC regime is complemented by the FIF regime, which applies when a foreign company is not controlled from New Zealand.

850.15 CFC definition [s EX 1]

A foreign company is a CFC for any accounting period of the company if any of the following three tests are met:

(a) At any time during that accounting period, there is a group of five or fewer New Zealand residents whose total control interests [see 850.25 for the definition of a “control interest”] in the company in any one of the categories of control interest is greater than 50 per cent; or

(b) At any time during that accounting period a single New Zealand resident holds a control interest in the foreign company equal to or greater than 40 per cent unless, at that time:
   (i) Another person also holds a 40 per cent or more control interest in the same control category; and
   (ii) The other person is not a resident; or
   (iii) The other person is not associated with the New Zealand resident; or

(c) There is a group of five or fewer residents who have the power to control the exercise of shareholder decision-making rights [see s YA 1 definition] for the company and thereby control the affairs of the company in accordance with the wishes of that group.

If any of the above tests is met at any time in the foreign company’s accounting period, the foreign company is treated as a CFC for the whole of its accounting period [s EX 1(3)].

An exclusion from the CFC rules is made in s EX 1(2) if the foreign company is a foreign PIE equivalent and one of the New Zealand residents is:

(a) A portfolio investment entity;
(b) An entity that qualifies for PIE status;
(c) A life insurance company.

“Foreign company” is defined in s YA 1 as a company that is:

(a) Not resident in New Zealand; or
(b) Treated under a double taxation agreement as not being resident in New Zealand [s YA 1].

850.20 Residence [ss YD 2, YD 3]

The CFC rules apply only to New Zealand residents that have income interests in companies that are controlled “foreign companies”.

A company is a “foreign company” if it is not resident in New Zealand or is treated as a resident of another country under a double taxation agreement — that is, the company is resident in New Zealand, but residence is assigned to another country for the purposes of a DTA (as per the definition in s YA 1).

A company is resident in New Zealand if it is treated as resident under s YD 2 [see 1250.60]. Section YD 2 determines New Zealand residence only. Thus, a company that does not meet the tests in s YD 2 is not resident in New Zealand.
Foreign company residence

Section YD 3 defines the country of residence of a foreign company. The purpose of the definition is to determine which foreign country a CFC is resident in for the CFC loss and foreign tax credit quarantining rules and the foreign currency conversion rules. The foreign company definition is also relevant to the FIF rules, as foreign companies represent the main category of FIF entity types. A further purpose of the rule in s YD 3 was to determine which foreign country a CFC was resident in for the purposes of the grey-list exemption. However, as the grey-list is now repealed for the CFC rules this purpose is otiose. Section YD 3 will still be relevant in determining if a foreign company is resident in Australia.

Note: The rules for determining a CFC’s residence in a grey-list country were subsumed into the rules in s YD 3. The ITA 2004 contained a separate set of rules.

Section YD 3 provides that a foreign company shall be deemed to be resident in a particular country or territory if, at any time during that accounting period, the company is liable to income tax in that country or territory by reason of domicile, residence, place of management or any other criterion of a similar nature. If, in the case of any company, there are two or more countries or territories or the company is not resident in any country or territory, the company shall be regarded as being resident in the country or territory in which, if that country or territory were New Zealand, that company would be treated as being resident by applying the tests in s YD 2 for a New Zealand company [s YD 3(4)]. If, this does not result in that company being treated as resident in one country or territory only, that company shall be regarded as being resident in the country or territory in which its centre of management is located [s YD 3(5)]. If there is no single country or territory of residence able to be determined, that company shall be regarded as being resident in such country or territory as the CIR determines [s YD 3(6)].

850.25 Calculation of control interest [ss EX 2, EX 3, EX 4, EX 5, EX 6, EX 7]

In looking to determine whether a foreign company is a CFC the control rules are seeking to determine which New Zealand residents have control. The rules focus on narrowing down the smallest number of people with the requisite level of control required, as per the requirements of s EX 1. Thus the control rules look at a person’s direct and indirect interests and the control interests of associated persons.

Control interests are measured in terms of categories of interests [s EX 2]. A direct control interest in a foreign company can arise in each of four separate categories of rights, being:

(a) Shareholding in the foreign company;
(b) Shareholder decision-making rights for the foreign company;
(c) Rights to receive income from the foreign company; and
(d) Rights to receive distributions of the company’s net assets.

The control interest of any resident at any time in any foreign company in each of the categories of control interest is calculated by aggregating at that time, for that category:

(a) Any direct control interest held by that person in that foreign company; and
(b) Any direct control interest or interests held in that foreign company by persons associated with that person whether those associated persons are residents or not; and
(c) Any indirect control interest or interests held by that person in that foreign company; and
(d) Any indirect control interest or interests held in that foreign company by persons associated with that person, whether those associated persons are residents or not.

A resident who does not hold at any time any direct or indirect control interests in a foreign company, and a non-resident relative of that person, are not under s EX 4(1), associated persons. This provision ensures, for example, that a foreign student studying in New Zealand is, by virtue of the associated person’s rules, deemed not to have a control interest in a CFC and trigger the disclosure and income attributions rules, because the person’s non-resident parents own a foreign company.

Under s EX 5 (which expands on the broad categories of control interest under s EX 2), a person has a direct control interest at any time in a foreign company if they hold, or are entitled to acquire or extinguish:
(a) Any of the shares in the foreign company, and for this purpose the interest is measured as the percentage of the total available subscribed capital per share, calculated under the slice rule, of the shares held as a percentage of the total available subscribed capital per share;

(b) Any of the shareholder decision-making rights for the company, and for this purpose, if the percentage varies between the rights comprising the “decision-making rights”, the highest percentage is taken;

(c) A right to receive, or to control the application of, any of the income of the company for the accounting period in which the time falls. For this purpose it is assumed that income is distributed on the last day of that accounting period and the entitlement of that person to receive the income is the same at all other times during that accounting period. For this purpose a payment on a ss FA 2 and FZ 1 debenture is deemed to be a distribution of income;

(d) A right to receive, or to control the application of, any of the value of the net assets of the foreign company if they are distributed.

An interest of a person is taken into account if they hold the interest, or they are entitled to acquire or extinguish the interest [s EX 6]. A person is entitled to acquire or extinguish something if the entitlement is absolute or contingent and whether the entitlement arises under the company’s constitution, the terms of an option, convertible note, or any arrangement substantially similar to all of the aforementioned or in some other way. However, a person is not treated as being entitled to acquire something if the entitlement arises under an arm’s-length security arrangement that conforms to generally accepted commercial practice.

Note: In determining whether the requisite control percentage is met, when taking the interests of associated persons into account, the interest is only counted once [ss EX 4(2) and EX 6(4)]. For example, a husband and wife that each own 25 per cent will have a control interest of 50 per cent each under the associated persons rules. However, they will not have a control interest of 100 per cent. Thus, if they are the only New Zealand resident shareholders there will not be a group of five or fewer New Zealand residents with control interests exceeding 50 per cent, although there may be a single New Zealand resident with a control interest of 40 per cent or more.

Indirect control interests are direct control interest that a CFC has in another foreign company. Under the control tests, if a CFC owns another foreign company, the controls interests that CFC has in the other foreign company are attributed back under s EX 7 to the group of persons that triggered the control test for the CFC (ie that caused the foreign company to be a CFC). When there is more than one group of five or fewer people holding interests of greater than 50 per cent in a CFC, the rules allocate the indirect control interests to the smallest group with the largest holding.

The rules in s EX 7 are applied on a hierarchical basis to determine who of the group of people that hold control interests in a CFC, will hold the indirect control interests in another foreign company. In applying the rules, a group of persons can include one person [s YA 1] and, when there is more than one person in a group of persons, the indirect interests are held pro-rata to their respective income interest in the first tier CFC.

When a CFC has a direct control interest in another CFC (including direct control interests held by associates), the hierarchical basis used by s EX 7 allocate that interest as follows:

(a) If there is only one group of persons whose control interests have deemed the first foreign company to be a CFC, to that group;

(b) If there is more than one group of persons, whose control interests have deemed the foreign company to be a CFC, to the group smallest in number; or

(c) If there are two or more groups that are the smallest in number, the interests are allocated to the group that has the highest control interest in the first CFC.

If at this stage there is still more than one group of persons, then the indirect interest is allocated in full to each group.

Note: As with the associated person’s rules, if the rules in s EX 7 would result in a direct control interest (including entitlements to acquire or extinguish) being counted more than once, for example because an
interest of a person associated with the first tier CFC is attributed back, that control interest is counted only once.

The reason why this approach is taken is because, there could well be other New Zealand resident people that hold control interests in the underlying foreign company, such that when the control rules are applied, there is not a group of five or fewer people resident in New Zealand that own more than 50 per cent of that foreign company, even though the first tier foreign company is a CFC. Hence the statement in s EX 7(4) to “ensure that the attribution exercise does not dilute recognition of a factual chain of control”.

If, under s EX 7 a foreign company becomes a CFC, s EX 7 is then applied to that company in relation to any control interest it holds in any underlying CFC.

**Example:**

Alan, Bob, Cory, Damien and Eddie are all New Zealand residents. In this case, Alan and Bob hold more than 50 per cent. As does: Alan + Bob + Cory; Alan + Bob + Cory + Damien, and Alan + Bob + Cory + Damien + Eddie.

<table>
<thead>
<tr>
<th>Holding</th>
<th>Total holding</th>
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<tbody>
<tr>
<td>Alan</td>
<td>30%</td>
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<tr>
<td>Bob</td>
<td>25%</td>
</tr>
<tr>
<td>Cory</td>
<td>20%</td>
</tr>
<tr>
<td>Damien</td>
<td>15%</td>
</tr>
<tr>
<td>Eddie</td>
<td>10%</td>
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850.30 **Calculation of income interest** [ss EX 8, EX 9, EX 10, EX 11, EX 12, EX 13, EX 14]

If, under the control interest rules, a foreign company is a controlled foreign company, it is then necessary to measure a person’s income interest in the CFC. Only persons with income interests of 10 per cent or more have attributed CFC income or loss. The rules for determining control and income interests are based on similar concepts. However, there are differences. For example, only direct income interests are taken into account. The interests of associated persons are only taken into account in determining whether a person has an interest of 10 per cent or greater [see 850.45]. The calculation of indirect interests is different for income interests. Also, entitlements to acquire an interest, such as an option, are not taken into account — although there are rules that focus on a person’s option to acquire an interest in a CFC when the terms of the option are such that a person can avoid holding an income interest, but nevertheless still get all the upside of ownership [s EX 11].

Under s EX 8, the income interest of any person at any time in any CFC shall be calculated by aggregating:

(a) Any direct income interest held by that person in that CFC; and
(b) Any indirect income interest held by that person in that CFC.

Like control interests, income interests are measured by category of interest. Section EX 9 sets out the categories and provides that a person has a direct income interest in a CFC at any time if they hold:

(a) Any of the shares in the foreign company, and for this purpose the interest is measured as the percentage of the total available subscribed capital per share, calculated under the slice rule, of the shares held as a percentage of the total available subscribed capital per share;

(b) Any of the shareholder decision-making rights for the company, and for this purpose, if the percentage varies between the rights comprising the “decision-making rights” [s YA 1] the highest percentage is taken;

(c) A right to receive, or to control the application of, any of the income of the company for the accounting period in which that time falls, that the person would be entitled to receive or to have dealt with in that person’s interest or on that person’s behalf, if that income were distributed on the last day of that accounting period and the entitlement of that person to receive income or have income dealt with
were the same at all other times during that accounting period. For this purpose a payment on a s FA 2 debenture is deemed to be a distribution of income;

(d) A right to receive, or to control the application of, any of the value of the net assets of the foreign company if they are distributed.

The income interest is measured by the percentage of the above interests held by the person. When the percentages between the categories of interest differ, the income interest is the highest interest held.

When a person has a direct income interest in a CFC, and the first CFC has a direct income interest in another CFC, the person has an indirect income interest in the underlying CFC.

The indirect income interest is calculated by multiplying the person’s direct income interest in the first CFC by the income interest of the first CFC in the underlying CFC. If there are two or more CFCs interposed between the person and the underlying CFC, then the indirect income interest or interests of the person in the underlying CFC shall be calculated by multiplying the direct income interests of each interposed CFC in each chain of CFCs in like manner.

Generally, an option to acquire an interest is not recognised as an income interest. Thus ensuring only interests in the CFC that have an entitlement to income or assets or an ability to control an entitlement to income or assets are actually used as the basis for attributing income. However, options will be taken into account in circumstances when they are used to defeat the intent and application of the CFC rules, in subpart CQ, subpart DN and subpart EX.

Section EX 11 applies when:

(a) A person (or another person, for example an interposed CFC) has at any time an option to acquire one of the types of income interest listed in s EX 9 in a CFC, but does not hold that interest at that time; and

(b) If s EX 11 did not exist, and having regard to the economic benefit that the person gets as a result of the CFC deriving income, the effect of the option would be to defeat the intent and application of the CFC rules; or

(c) The consideration payable for the exercise of the option is less than the market value of the interest subject to the option; or

(d) The holder of the option (or an associated person) has directly or indirectly funded or assisted the actual holder to acquire or hold the interest subject to the option.

If these conditions are met, the person’s income interest is deemed to be calculated as if the option holder had exercised the option [s EX 11(5)].

The section does not apply if the actual holder of the interest subject to the option is a CFC or a New Zealand resident, unless they are a New Zealand resident whose income interest in the CFC is less than 10 per cent under ss EX 14 to EX 17.

When the income interest of any person in any CFC varies during any accounting period of the CFC, the income interest is calculated using the formula in s EX 17. The formula gives a weighted average interest to be applied for the full income year. The reason for this is because the CFC rules attribute CFC income using only one interest: separate calculations are not undertaken if the income interest varies.

When a person’s interest in a CFC varies during an accounting period, the person’s interest is calculated for each period that the person’s interest remains unchanged, by adding the amounts determined by the following formula:

\[
\text{income interest for day / days in period} = \frac{\text{income interest for day}}{\text{days in period}}
\]

**Example 1:**

A person with a 100 per cent income interest in a CFC with a 31 March balance date sells their full interest in the CFC on 30 September, being 183 days into the accounting period. The person’s interest in the CFC for the full year of the CFC is:

\[
\frac{100}{183} = 54.65\%
\]
In determining the income interest for day in the formula, the interest is the income interest for the day if the interest does not vary during the day. If the interest varies during the day the interest at the start of the day is used.

Note: This seems to differ from the formula used in the ITA 2004 which was income interest x (days when interest unchanged / days in the accounting period). If that formula were used the result was 100% × (183 / 365) = 50.13%

In terms of s EX 16(2), if a person is not resident in New Zealand at all times during a day, the person’s income interest in the CFC on that day is zero. The fact that the formula averages a person’s interest over the full year can sometimes cause anomalies.

Example 2:
If the vendor in the above example had been making losses, and under the new shareholders control the company makes a profit for the full accounting period, the vendor will have a 50 per cent income interest in the full year’s CFC income, even though the vendor has no economic interest in those profits.

850.35 Cases where aggregate income interests are greater than 100 per cent [s EX 12]

When the aggregate income interests used to calculate attributed CFC income or loss (which also included attributed repatriations prior to the repeal of those rules for all income years beginning on or after 1 July 2009 — see 850.80) of residents from any CFC for any accounting period exceeded 100 per cent, the income interest of that person shall be that percentage calculated in accordance with the following formula:

\[
\text{Income interest before reduction} \times \frac{100}{\text{total income interests before reduction}}
\]

Income interests in a CFC could exceed 100 per cent in total because a person with an income interest in the CFC is required to use the highest of any interest they have in the CFC in terms of s EX 9(3). For example, a person holds 100 per cent of the voting rights in a CFC, but another shareholder holds 100 per cent of the profit entitlement rights. This would give total income interests of 200 per cent.

850.40 Attribution of CFC income and loss [ss CQ 2, DN 2, EX 18]

Attributed CFC income of a person is income under s CQ 1. A deduction for an attributed CFC loss is available under s DN 1. The general rules for determining when a person is required to take attributed CFC income or losses into account are contained in ss CQ 2 (CFC income) and DN 2 (CFC losses).

A person has attributed CFC income from a foreign company in an income year, if:

(a) The foreign company is a CFC at any time during the foreign company’s accounting period (ie when the control test in ss EX 1 to EX 7 is met at any time during the foreign company’s accounting period);

(b) The accounting period of the foreign company ends during the person’s income year;

(c) The person has an income interest (under ss EX 8 to EX 13) of 10 per cent or more in the CFC at any time in its accounting period;

(d) The person is a New Zealand resident (not being a transitional resident) [see 370.35] at any time during the accounting period;

(e) There is net attributable CFC income for the accounting period calculated under s EX 20, or if the CFC is in receipt of a taxable distribution from a non-qualifying trust, the rules in s EX 19 that allocate the taxable distribution to the people with income interests in the CFC apply. Although the taxable distribution does not form part of the net attributable CFC income, it is nevertheless still treated as attributed CFC income;

(f) The CFC is not a non-attributing active CFC for the accounting period under s EX 21B (that is if less than five per cent of the CFC’s total income is attributable income); and

(g) The CFC is not a non-attributing Australian CFC under s EX 22 for the accounting period.

There are two special rules highlighted in s CQ 2 when income is always attributed regardless of the residence or active/passive status of the CFC. The first is when s CQ 2(2) applies. This provision mirrors the rule in s EX 19 that applies when a CFC receives a taxable distribution from a non-complying trust. The rule in s CQ 2(2) requires a person with an interest in a FIF and uses the branch-equivalent method of calculating FIF income, to treat a taxable distribution received by the FIF as attributed CFC income.
The second special rule is when s CQ 2(2B) applies. This provision applies when a CFC derives personal services income that is an attributable CFC amount under s EX 20B(3)(h). Such income or loss is always attributed, even if the CFC is a non-attributing active CFC or a non-attributing Australian CFC.

Attributed CFC income of a person who has ceased to be resident in New Zealand during the income year is treated as being derived by that person while resident in New Zealand. That is, attributed CFC income is not apportioned for their period of residence and non-residence: instead this is adjusted in the formula in s EX 17.

The rules in s DN 2 for taking an attributed CFC loss into account, leaving aside quarantining, are essentially the same as those for attributed CFC income (discussed above).

The calculation of the actual attributed CFC income or loss is undertaken in accordance with the formula in s EX 18. That section links back to ss CQ 2 and DN 2 and states that when the conditions in those sections are satisfied and a person has attributed CFC income or a loss, then the amount of the income or loss is determined by multiplying the person’s income interest in the CFC for the accounting period, by the net attributable CFC income or loss of the CFC for that accounting period.

850.45 Persons not required to calculate attributed foreign income and loss [ss CQ 2(1)(d), DN 2(1)(d), EX 14, EX 15, EX 19(5), EX 21(35), EX 58(7), EZ 31]

The general rule is that no person with an income interest in a CFC shall calculate attributed CFC income or attributed CFC loss for an income interest in a foreign company for any accounting period when:

(a) That person at all times in that accounting period is not a resident or is a person who is a transitional resident [ss CQ 2(1)(d) and DN 2(d)];

(b) That income interest for that accounting period is not an income interest of 10 per cent or greater [s EX 14]; or

(c) Section EZ 31 applies [ss EX 19(5), EX 21(35) and EX 58(7)].

For the purposes of s EX 14 [and also for the purposes of ss CQ 2, EX 21, EX 34 and EX 58], in determining whether the income interest of any person in a CFC for any accounting period is an income interest of 10 per cent or greater, s EX 15 provides that a person’s income interest in a CFC is increased by each income interest, for the relevant accounting period of an associated person. Interests held by an associated person that is a CFC are specifically excluded to avoid double counting the interest.

**Example:**

Company A and Company B are associated persons and they each hold an income interest in a CFC of five per cent, prima facie under s EX 14 they do not have a sufficient interest of 10 per cent in the CFC, and are thus not required to attribute CFC income or losses. However, because of the associated person rule in s EX 15, both Company A and Company B will be considered to have an income interest of 10 per cent. Thus, both Company A and Company B will have to attribute CFC income or losses. However, this is calculated on the basis of their actual interest of five per cent.

Prior to its repeal for all income years beginning on or after 1 July 2009, under s EZ 31, no branch-equivalent income or loss calculated under s EX 21, FIF income or loss calculated under s EX 58, or additional CFC income under s EX 19, arose when a CFC was resident in a grey-list country and the company was listed on a recognised exchange in that country whose rules prevented the New Zealand resident with the interest in the CFC obtaining sufficient information to calculate income under the CFC rules.

The s EZ 31 exemption originally applied from the 2001-2002 to the 2005-2006 income years, inclusive. The exemption did not apply for any income year for which a return of income was filed before 31 March 2003. The exemption was extended up to and including the 2010-2011 tax year [Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006, s 103] and repealed by s 195 of the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009.
Exemptions from the attribution of CFC income and loss [ss CQ 2, DN 2, EX 21B, EX 21C, EX 21D, EX 21E, EX 22, EX 23]

A person with an income interest of 10 per cent or more in a CFC will not have to include attributed CFC income or loss in the person’s gross income if the CFC passes an active business test. A CFC will pass the active business test and be a non-attributing active CFC if it has attributable income that is less than five per cent of its total income. Attributable and total income (for the purposes of the test), are measured using either financial accounting or tax measures of income.

CFCs in the same country may be consolidated for the purposes of the calculation of the five per cent ratio calculation. A CFC will also be a non-attributing active CFC for a person with an income interest in the CFC, if the person has applied for and obtained a determination from Inland Revenue that the CFC is an active insurance business under s 91AAQ of the TAA.

The other principal exemption applies when the CFC is resident and subject to income tax in Australia, and meets certain other conditions in s EX 22. Thus, if the Australian exemption does not apply, it will be necessary to determine if the CFC passes the active business test.

Active business test — broad outline [ss EX 21B-EX 21E]

If the Australian exemption does not apply it will be necessary to decide if the active business exemption is met. The first decision in this regard is whether to use tax or accounting concepts (standards) of income. Section EX 21B contains the broad framework to be used in this regard. It states that a non-attributing active CFC is a CFC that:

(a) Meets the requirements of s EX 21D (ie has a ratio of attributable to total income, using tax measures of income of less than five per cent); or
(b) Is able to and chooses to apply s EX 21E, and meets the requirements of that section (ie has a ratio of attributable to total income, using accounting measures of income of less than five per cent); or
(c) Meets the requirements of a determination made by the CIR under s 91AAQ of the TAA (ie is a CFC with an active insurance business).

Section EX 21C sets out the rules that must be met in order to use accounting standards for the purposes of the rules in s EX 21E [see 850.58].

If accounting standards of measuring income are to be used, they can be used for a single CFC or for a test group of CFCs. If the measures are to be used for a test group, the income of the CFCs in the test group is consolidated for the purposes of calculating the five per cent ratio of attributable to total income. Consolidation of the group income for this calculation may be advantageous. It will of course be necessary to determine the test group, which for the purposes of the accounting measures test is contained in s EX 21E(2).

If accounting standards of measuring income is not able to be used for the CFC or the test group, tax measures of income will have to be used. These rules are found in s EX 21D and termed the “default test”. If tax measures of income are to be used (as with the accounting standards test), they can be used for a single CFC or for a test group of CFCs. The test group is determined by the rules in s EX 21D(1).

If an accounting standard is used, the formula in s EX 21E(5) is then applied. The formula is the ratio of attributable income to total income. There are six components in the formula in s EX 21E(7) to (12). Rules in s EX 21E(4) govern how the calculation is to be done. Section EX 21E(3) explains (based on the result of the calculation) whether the CFC or the CFCs in the test group qualify for the active business exemption. The accounting standards test is discussed at 850.57.

The formula for the default test is contained in s EX 21D(4). There are four components in the formula in ss EX 21D(6) to (9). Rules in s EX 21D(3) govern how the calculation is to be done. Section EX 21D(2) explains, based on the result of the calculation, whether the CFC or the CFCs in the test group qualify for the active business exemption. The default test is discussed at 850.56.
Note: There is no ordering rule for whether accounting standards or tax concepts for calculating the active business test are used. This all depends on which method is appropriate for the person with the income interest in the CFC. Technically, different people with income interests in the same CFC could use different methods.

850.56 Non-attributing active CFC — default test [s EX 21D]

Section EX 21D sets out the rules for calculating the ratio of attributable income to total income when using tax measures of income. The ratio may be calculated either for a single CFC or for a test group of CFCs. If the ratio is not less than zero and is less than 0.05, then the CFC, or in the case of test groups, all the CFCs in the test group, will be non-attributing active CFCs, unless prevented from being so for some other reason (eg the application of s GB 15C).

The ratio calculation, with only one exception, is based on amounts of income and no deductions for expenditure or losses incurred are included in the calculation. Section EX 21D(1) contains the requirements that must be met for the ratio to be calculated for a test group of CFCs. Essentially, the requirements for a test group of CFCs treats the group as a single consolidated entity. The requirements that must be met are:

(a) That all the companies must be resident in the same country. The test for residence in this case is that all of the companies are liable for income tax in the same country by reason of domicile, residence, place of incorporation, or centre of management. For example, a CFC that is liable for tax in a country because of the presence of a permanent establishment in that country will not make it resident for the purposes of this test.

(b) The person with the interest in the CFC holds an income interest of more than 50 per cent in each of the CFCs in the test group. This is intended to prevent a CFC being a part of a test group for more than one interest holder.

(c) All CFCs in the group must make the same choice of method and currency under s EX 21(4). They must either all make the choice to convert all transactions to New Zealand dollars at the applicable daily rate, or all make the choice to use the same reporting currency. If the reporting currency is used, s EX 21(5) and (6) must be observed in the normal way, and s EX 21(7) will apply to certain financial arrangements. The purpose of this provision is to limit the scope for manipulating the test by the deliberate choice of different reporting currencies for CFCs within the group.

(d) The CFCs in the test group must be consolidated for the purposes of the test (and only for the purposes of the test). Consolidation requires the elimination of all intra-group balances, transactions, income and expenses, and the use of like tax treatments for like transactions. For example, it would not be appropriate for different CFCs in the test group to use different options for calculating financial arrangement income for the same type of financial arrangement. Inland Revenue advises that it is expected that elimination of intra-group transactions will be carried out in a way that is consistent with accepted accounting principles. Thus it is not expected or intended that there will be rigid compliance with any particular set of financial accounting standards. The rules for consolidation in subpart FM are not to be used for the consolidation of CFCs.

Section EX 21D(2) designates a CFC (whether alone or as part of a test group) as a non-attributing active CFC if the ratio of attributable income to total income in s EX 21D(4) is less than 0.05 and, if zero, is not zero because of the application of s EX 21D(3)(f) (which sets the ratio to zero if the denominator is a negative number). The ratio may be zero because attributable income is zero and there is some total income. In that case, the CFC is a non-attributing active CFC. If the ratio is zero for any other reason (ie s EX 21D(3)(f) applies because the denominator is a negative number), the CFC is not a non-attributing active CFC. This is because a negative denominator implies either an unintended result or no activity. When this happens, attribution is required.

Section EX 21D(3) explains how to apply the ratio formula in s EX 21D(4). If the formula is being applied for a test group, the test group is notionally treated as a single consolidated entity for these purposes. Each item in the formula in s EX 21D(4) is determined for a test group after amounts that relate to income interests not held by the interest holder are removed; thus if the group is not wholly owned consideration of the shareholding of each company in the group will be required.
Consistent with the single-notional-entity approach, for the purposes of the formula in s EX 21D(4), rules apply to determine when the test group is associated with a company or in the same group of companies as a company. Essentially the rule treats any company associated to a test group company, or in the same group of companies as a test group company, as associated to the test group or a member of the same group of companies as the test group. Thus:

- A company is associated with the test group if the company is associated with a member of the test group but is not a member of the test group; and
- A company is a member of the same group of companies as a test group if the company is in the same group of companies as a member of the test group, but is not a member of the test group.

However, in both cases it is not necessary that the company is a member of the test group. As mentioned, these rules apply only for the purposes of calculating the formula. They do not affect, for example, the application of the loss offset rules in Part I.

If either the numerator or denominator in the formula is negative, the ratio is treated as being zero. The legislation does not anticipate a negative numerator or denominator. However, if a negative result is produced, the result is set to zero.

If the denominator in the ratio formula is zero, the ratio is set to zero and the CFC will not be a non-attributing active CFC. A nil denominator implies either an unintended result or no activity on the part of the CFC and so attribution is required.

The formula to calculate the ratio is contained in s EX 21D(4), which provides:

\[
\frac{\text{attributable} - \text{attributable adjustment}}{\text{gross} - \text{gross adjustments}}
\]

The numerator (attributable – attributable adjustment) contains the calculation of attributable income, being the attributable CFC amount for the CFC (or test group notionally treated as a single CFC) calculated under s EX 20B (using the rules in s EX 21), less two optional adjustments specified in s EX 21D(7). The two optional adjustments are:

(a) The interest holder may choose to remove amounts relating to personal services under s EX 20B(3)(h). These amounts are always attributable, but the adjustment means a CFC may qualify for the active business exemption in relation to its other income. It is not possible to remove the amount if it would also come within another paragraph of ss EX 20B(3) or EX 20B(4). The removal of the amount is only for the purposes of applying the active business exemption.

(b) The interest holder may choose to subtract the cost of revenue account property when there is an amount under s EX 20B(3)(k). This provision brings in income from the disposal of revenue account property (that is not a share, financial arrangement or life insurance policy), that is used by the CFC with a purpose or effect of giving rise to income of the CFC referred to in another paragraph of s EX 20B(3). The effect of the adjustment is that only a net amount is included in attributable income. The adjustment is limited to the part of the cost of the property that would be allowed as a deduction for the period under s EX 20C, but also may not be more than the amount under s EX 20B(3)(k). In this way, net losses on disposal are not possible. This is for partial consistency with the use of gross amounts in the ratio calculation. If any amounts would be required to be added back in relation to the deduction under subpart CH, they must also be added back in the formula.

The denominator (gross – gross adjustments) is defined in ss EX 21D(8) and EX 21D(9). “Gross” is the annual gross income for the accounting period. Annual gross income is calculated generally as if the CFC were a New Zealand resident. As with the calculation of the attributable CFC amount (under s EX 20B), s EX 21 applies to the calculation of annual gross income. The definition excludes income arising under s CQ as CFC’s do not calculate income under the CFC of FIF rules.

There are four adjustments contained in s EX 21D(9). The first is the amount of any optional adjustment made to the numerator under s EX 21(7). The second is the removal of any expenditure or loss included in the calculation of the attributable CFC amount under s EX 20B. In practice, it is unlikely that there would be any such amounts as s EX 20B includes only income; this adjustment is purely a protective measure. The third adjustment is the removal of income derived by the CFC from a company, if the CFC and the company
could be members of the same test group under s EX 20D(1). The purpose of this adjustment is to prevent the inflation of total income by transactions between associated entities.

**Note:** In determining whether the CFC and the company could be members of the test group, it is not relevant that the required consolidation has actually been undertaken or not. It is relevant that if a person were to undertake the required consolidation, the CFC and the company would be eligible to be members of the same test group.

The fourth adjustment is the removal of income derived by the CFC from a supply to a company that could not be a member of a test group with the CFC, if the supply was made with the purpose of inflating the measure of total income [s GB 15B].

The third and fourth adjustments have a similar purpose, with the following differences:

(a) The third adjustment applies to income derived by a CFC from a company that could be part of a test group with the CFC, while the fourth adjustment applies when the company could not be part of a test group with the CFC; and

(b) The third adjustment does not require any purpose, while the fourth adjustment requires the purpose of increasing the measure of total income.

850.57 **Active business exemption using accounting standards** [s EX 21E]

Section EX 21E contains the rules for calculating the ratio of attributable income to total income when using accounting measures of income. This section needs to be read in conjunction with s EX 21C as an applicable accounting standard must be able to be used for the purposes of s EX 21E.

The ratio is calculated either for a single CFC or for a test group of CFCs. If the ratio of attributable income to total income is less than 0.05, (its attributable income is not negative, and its total income is greater than zero), then the CFC (or every CFC in the test group) will be a non-attributing active CFC.

Under s EX 21E(2) a test group can be used for any CFC in that group if:

(a) The group consists of companies required under the accounting standard to consolidate;

(b) Each company is resident in the same country;

(c) The interest holder holds an income interest of more than 50 per cent in each company;

(d) Each company has the same functional currency; and

(e) There are audited and consolidated financial statements that include the accounts of the companies in the group (whether or not the accounts of companies not in the group are also included) and comply with the applicable accounting standards.

**Note:** Section EX 21E(13) states that the financial statements will be taken to comply with the applicable accounting standard if they meet the requirements of s EX 21C in relation to that standard [s EX 21C(9)]. Section EX 21E(13) also deals with compliance with accounting standards.

**Note:** Section EX 21C also imposes requirements relating to the sets of accounting standards (the applicable accounting standard) that may be used by the test group. It is possible that the requirements of s EX 21E(2) will be met, but that no applicable accounting standard will be available for use under s EX 21C. In that case, the ratio may not be calculated for the test group under s EX 21E.

If the ratio in s EX 21E(5) is calculated for a test group, the test group is generally treated as a single CFC for the purposes of the calculation. Amounts for the test group must be consolidated under the applicable accounting standard. This requires elimination of transactions, balances, income and expenses between the group members. If consolidated financial accounts exist that include the accounts of companies in the test group and only those companies, it may be possible to use those accounts without alteration. However, if consolidated accounts include entities that are not members of the test group, a sub-consolidation will be required for the test group. Information from consolidation worksheets may be used for this purpose, providing it meets the requirements of s EX 21E(13).
The test group is treated as a single entity for the purposes of s EX 21E, and, as with the default test in s EX 21D, there are rules for determining when a company who is not a member of the test group is associated with the test group, or is a member of the same group of companies as the test group.

Each item in the ratio formula in s EX 21E(5) is to be adjusted to remove amounts attributable to minority interests. “Minority interest” is not defined in the legislation. However, according to Inland Revenue a minority interest is an interest in the CFC held by a person who is not the interest-holder calculating the ratio.

Removal of amounts attributable to minority interests is most relevant for test groups. For an individual CFC, removal of these amounts is expected to affect all amounts equally so that the ratio in the formula is unchanged. For a test group, removal of minority interest amounts is necessary to prevent all the income of an active business that is only partly owned by a New Zealand resident from sheltering attributable income of a company that is wholly owned by that resident.

Section EX 21E(5) is the ratio formula provision. However, s EX 21E(4) explains how the ratio calculation in s EX 21E(5) is to be undertaken.

Amounts used in the calculation must be determined under the applicable accounting standard. Amounts are taken to be determined under the applicable accounting standard if they are actually determined under that standard, or if the requirements in s EX 21E(13) are met. Having said that, some of the adjustments to base measures of attributable income and total income in s EX 21E(5) require the use of tax measures of income or expenditure, and thus will not be determined under the applicable accounting standard.

Each item in the formula must be adjusted so that there is no double counting of amounts [s EX 21E(4)(a)]. Double counting could occur if an amount was income under more than one paragraph of s EX 21E(7). For example, income from a financial arrangement under s EX 21E(7)(f) and income from property used to back insurance assets under s EX 21E(7)(h).

Section EX 21E(4)(f) requires that amounts are to be determined for a CFC using the functional currency of the CFC. Thus, the formula is not undertaken in New Zealand dollars. The functional currency of a CFC is determined by the applicable accounting standard and cannot be freely chosen. The concept of “functional currency” is more restrictive than the concept of “the currency of the CFC’s financial accounts” in s EX 21E(4).

Amounts may have to be translated from a currency that is not the functional currency of the CFC, such as when the CFC makes sales outside its own country. In that case, conversion to the functional currency must comply with the applicable accounting standard. Translation under the applicable standard will frequently result in the recognition of an exchange rate gain or loss, which may need to be included in measures of attributable or total income. The one exception to the general rule is that exchange differences arising on monetary items that form part of a net investment of the CFC in a foreign operation are ignored. A monetary item that is part of a net investment in a foreign operation is an item for which settlement is neither planned nor likely to occur in the foreseeable future (eg see the definition in International Accounting Standard IAS-21).

A test group applies the same rules for exchange rate conversion as an individual CFC. That is, conversion to the functional currency must comply with the applicable accounting standard. Consolidated financial accounts are presented in a presentation currency, which may differ from the functional currency of any of the entities whose accounts are being consolidated. Because all the entities in a test group will have the same functional currency, conversion to a different presentation currency is unnecessary and the functional currency should be used. For the avoidance of doubt, the legislation requires that if a presentation currency is used to calculate amounts, translation of all amounts from the functional to the presentation currency must be undertaken using an average exchange rate for the year [s EX 21E(4)(g)]. The effect is that the amounts in presentation currency will be nothing more than a scaled-up or scaled-down version of the amounts in the functional currency.

Section EX 21E(5) contains the formula for calculating the ratio of attributable income to total income using accounting measures of income.

The formula is:
(reported passive + added passive – removed passive) / (reported revenue + added revenue – removed revenue)

The numerator in the formula consists of a base measure of attributable income (reported passive). There are subsequent compulsory upward adjustments (added passive), and then optional downward adjustments (removed passive). Double counting and double removal are prevented by requiring that amounts are included in added passive only to the extent they are not already included in reported passive. Amounts are included in removed passive only to the extent that they are already in reported passive or added passive.

The denominator in the formula consists of a base measure of total income (reported revenue). There are subsequent optional upward adjustments (added revenue) and compulsory downward adjustments (removed revenue). As with the numerator, double counting and double removal are prevented.

Section EX 21E(7) defines the terms in the formula in s EX 21E(5).

(1) Reported passive

Reported passive includes:

(a) Dividends;
(b) Interest;
(c) Royalties;
(d) Rental;
(e) Income from a finance lease or operating lease (that is not rent or interest);
(f) Income or loss from a financial asset, other than a derivative (as defined in NZIAS-39) or a share that is not revenue account property, in the form of:
   (i) A change in fair value of the asset;
   (ii) A gain or loss on derecognition, as defined in NZIAS-39;
   (iii) A foreign exchange gain or loss on the asset;
(g) Income or loss from a derivative, as defined in NZIAS-39 when:
   (i) The derivative is held in the course of a business for the purposes of dealing;
   (ii) The derivative is not entered in the ordinary course of a business of the CFC; or
   (iii) The derivative is part of a hedging relationship (as defined in NZIAS-39) and an amount would increase the numerator in the formula or when the derivative would produce such an amount of income or gain;
(h) Income or gains from the business of insurance, including income or gains from property used to back insurance assets.

Note: The terms derivative, derecognition and financial asset are all derived from NZIAS-39 for the reason that generally accepted accounting practice without IFRS does not adequately define the terms. However, once defined, the applicable accounting standard is then used to measure the income. For example, if generally accepted accounting practice without IFRS is used, NZIAS-39 is used to identify the assets of the CFC that are financial assets. Having identified the financial assets, generally accepted accounting practice without IFRS is then used to measure any income or loss.

The amounts of reported passive income are included on a gross basis, whether or not derived in the ordinary course of business. Importantly these terms have the meanings they have under the applicable accounting standard, rather than their tax meanings. For example, if generally accepted accounting practice with IFRS or IFRSEs is used, International Accounting Standard IAS-18 (Revenue) provides guidance about the recognition of dividends and royalties when received in the ordinary course of business. International Accounting Standard IAS-17 (Leases) provides some guidance about the recognition of interest, rents and other lease income under a lease. Inland Revenue advises that if the applicable standard provides no guidance, the meanings of dividend, royalty, rental and lease should be determined according to the general
understanding of accountants who would apply the standard. Presumably other authoritative statements could be relied on also if these were used in the preparation of the accounts.

**Note:** The label given to a component of income in the accounts or on the face of financial statements does not determine the character of the amount. For example, if an amount would be a royalty under International Accounting Standard IAS-18, but is included in “other income” in the statement of financial performance because it is not in the ordinary course of business, it is still a royalty for the purposes of s EX 21E(7).

Another example arises when reported passive income is interest income. This is measured on a gross basis (with no deduction for expenses). Interest income is recognised under generally accepted accounting practice with IFRS and IFRSEs under International Accounting Standard IAS-18, when the interest is received in the course of ordinary activities of the entity. That standard specifies that the effective interest method (set out in International Accounting Standard IAS-39) is to be used to calculate the amount of interest income (this is essentially yield-to-maturity). Interest income will also be recognised when not received in the ordinary course of the activities of the entity. Again, the effective interest method would normally be used. It is expected that similar principles would apply under generally accepted accounting practice without IFRS, although there is no relevant standard to spell this out.

When the income or loss is a change in the reported fair value of a financial asset, a gain or loss on the derecognition of the asset or a foreign exchange gain or loss on the asset [as per s EX 21E(7)(f)], income or loss is to be included regardless of whether or not it appears in the income statement or elsewhere in the accounts. Losses will occur if the reported fair value declines, there is a loss on derecognition of the asset, or there is a foreign exchange loss on the asset.

**Note:** Losses will not occur because expenditure (ie the cost of borrowing to purchase the asset) has been incurred in deriving income from the asset. Such expenditure is ignored for the purposes of the ratio calculation. Some items of income can fall under more than one category for the purposes of s EX 21E(7). For example, some interest income is recognised under s EX 21E(7)(b) even though it flows from the holding of a financial asset. If an amount is included under paragraph (f) and another paragraph, s EX 21E(4)(a)(ii) allows an adjustment to prevent double counting.

Other points to note are:

(a) Income or losses from shares that are not revenue account property are excluded from the ambit of s EX 21E(7)(f) because any gains or losses on these shares would not be income or loss if tax measures of income were used. The term “revenue account property” is defined in s YA 1.

(b) Income or loss from a derivative instrument is included only if the instrument is held for dealing, not held in the ordinary course of business, or is hedging the accounting measure of attributable income or a transaction that would give rise to such attributable income [s EX 21E(7)(g)]. Thus, in general, derivative income or losses will not be in reported passive when they are the result of hedges of active income.

(c) Section EX 21E(7)(g) requires any hedging relationship (that hedges the numerator in the formula, reported and added passive less removed passive) to be of a type defined in NZIAS-39. As with s EX 21E(7)(f), again, this applies to identify when there is a hedging relationship, not to measure any income or loss from the derivative instrument.

(d) It is not necessary for a hedging relationship to qualify for hedge accounting treatment under generally accepted accounting practice with IFRS or IFRSEs, which requires proper designation of the hedge and that the hedge be highly effective. If a hedging relationship is not effective or only partly effective, it may well be that any gain or loss from the hedge will be attributable income as it may not be held in the ordinary course of business or the business deals in derivatives.

(e) When a hedge is effective such that a hedging relationship exists, but the hedge is still partly ineffective, the part of the gain or loss that reflects the ineffective portion of the hedge is likely to be included in attributable income. This is because the legislation does not limit the income or loss to the amount attributable to the effective portion of the hedge. This is the case even though income or loss from the ineffective portion of the hedge may be presented in a different line item in the accounts.
(f) If a CFC uses a derivative to hedge a transaction that gives rise to both non-attributable and attributable income, the hedge gain or loss is recognised only to the extent it relates to the hedging relationship with attributable income. This will require apportionment on a reasonable basis. Further, any income or loss attributable to the ineffective portion of a hedge will usually be included in the amount to be apportioned and counted accordingly.

(g) Income or gains from a business of insurance includes premium income from insurance or reinsurance activities. It also includes income or gains from property used to back insurance assets, such as interest, dividends, rents or fair value changes flowing from assets held to satisfy future insurance claims.

(2) **Added passive**

Added passive is defined in s EX 21E(8) and is the compulsory upward adjustments to the base measure of reported passive. There are four adjustments:

(a) Income from a life insurance policy that is included in the attributable CFC amount for the accounting period under ss EX 20B(3)(g) and EX 20B(8) when there is a distribution from a life insurance policy or there is income from the disposal of life insurance policies held on revenue account. Life insurance policies are included as added passive income because they can be used as substitutes for interest bearing investments. The amount to be included is the tax concept of income.

(b) Income from the disposal of revenue account property that would be included in the attributable CFC amount under s EX 20B(3)(k). The adjustment does not apply to the disposal of a share, a financial arrangement or a life insurance policy, because they are covered by other provisions. The adjustment also does not apply unless the property is used in a way that gives rise to income or gains that increase the accounting measure of attributable income (the numerator in the formula). The amount of the upward adjustment is the same as the amount that would be included under s EX 20B(3)(k), except to the extent the amount is already included in reported passive. Section EX 21E(9)(d) allows a reduction (in the value of the numerator) for the cost of the property.

(c) Income from services (base company income) under s EX 20B(3)(l) to the extent to which the service is physically performed in New Zealand.

(d) Income from the supply of telecommunication services that arises under ss EX 20B(3)(m) and EX 20B(3)(n).

(3) **Removed passive**

Removed passive is defined in s EX 21E(9) and is an optional downward adjustment to the base measure of reported passive. There are four adjustments:

(a) Dividends that are not included in the attributable CFC amount under ss EX 20B(3)(a) to EX 20B(3)(c). The amounts removed are only removed to the extent they are already included in reported passive or added passive.

(b) Royalties that would have been included in the attributable CFC amount in s EX 20B(3)(d) but for the fact that they are excluded by ss EX 20B(5)(a) to EX 20B(5)(d). The amounts removed are the amounts determined using tax measures of income. Removal is permitted only to the extent the amounts were already included in reported passive or added passive.

(c) Rents that would have been included in the attributable CFC amount in s EX 20B(3)(e) but for the fact that they are excluded by ss EX 20B(7)(a) to EX 20B(7)(c). The amounts removed are the amounts determined using tax measures of income. Removal is permitted only to the extent the amounts were already included in reported passive or added passive.

(d) The cost of revenue account property that produced an attributable CFC amount under s EX 20B(3)(k). The amount included under s EX 20B(3)(k) was included on a gross basis in added passive. The effect of subtracting the cost ensures only the net amount from the sale is included in attributable income. The amount subtracted may not exceed the gross proceeds of the sale included in added passive. Further, any amounts that would have to be added back in relation to the deductions
under subpart CH, if the CFC were a New Zealand resident, reduce the amount of cost that is subtracted.

(4) Reported revenue

Section EX 21E(10) defines the base measure of total income (reported revenue) used in the ratio of attributable income to total income. In accounting terms, reported revenue is not always an exact science in terms of where it may be recorded in the financial accounts. Thus, there may be cases when the provisions of s EX 21E(1) pick these amounts up more than once. Regard should always be made to s EX 21E(4)(a) that excludes double counting.

At the heart of reported revenue for CFCs with active businesses will be “revenue” as per International Accounting Standard IAS-18 (Revenue) when using IFRS or IFRSE. If the applicable accounting standard is generally accepted accounting practice without IFRS, the amount of revenue to include is the amount reported as “operating revenue”. It is expected that revenue (under any standard) will usually include income from interest, dividends and royalties. Revenue is also expected to include most income from the supply of services, such as attributable CFC amounts under ss EX 20B(3)(l) to EX 20B(3)(n). Most lease income is excluded from IAS-18, so this income is included separately in s EX 21E(10)(b). Income from the business of insurance is also dealt with separately as International Financial Reporting Standard IFRS-4 (and its New Zealand equivalent) is explicitly excluded from IAS-18 (and its New Zealand equivalent).

Gains or losses on non-derivative financial assets are included at s EX 21E(10)(c). The description of this item is identical to the description in s EX 21E(7)(f).

Gains or losses on certain derivative instruments are included at s EX 21E(10)(d). The description of this component is very nearly the same as the description in s EX 21E(7)(g), except that s EX 21E(10)(d)(iii) refers to a gain or loss from a hedging relationship affecting an amount that would change the denominator, whereas s EX21E(7)(g)(iii) refers to the impact on the numerator. Thus the difference is that instead of the hedging relationship being with the accounting measure of attributable income, or transactions that would give rise to such attributable income, the hedging relationship is the accounting measure of total income. This last point is important as hedges of expenses or liabilities are (according to Inland Revenue) not related to the derivation of revenue and are thus excluded from reported revenue in the denominator.

Income or gains from the business of insurance are the final component of reported revenue.

(5) Added revenue

Section EX 21E(11) defines the optional upward adjustments to the base measure of total income. There are two adjustments. They add income from a life insurance policy that is included in the attributable CFC amount under s EX 20B(3)(g) or income from the disposal of revenue account property that is treated as an attributable CFC amount under s EX 20B(3)(k) and the property is not a share, financial arrangement or life insurance policy, and it is used in such a way so as to give rise to income or gains that increase the numerator. The reason these adjustments are separately identified is that they are not likely to be included in revenue or operating revenue, because they will often not arise in the ordinary course of business.

(6) Removed revenue

Section EX 21E(12) defines the compulsory downward adjustments to the base measure of total income. There are seven adjustments required.

The first is the removal of the cost of revenue account property, if it was also removed from the measure of attributable income under s EX 21E(9)(d).

The second is the removal of the amount of a dividend, if it was also removed from the measure of attributable income under s EX 21E(9)(a) (ie dividends not included in attributable CFC income under ss EX 20B(3)(a) to EX 20B(3)(c)).

The third adjustment is the removal of personal services income that would be an attributable CFC amount under s EX 20B(3)(h). This income is disregarded for the purposes of the ratio calculation, as it is still taxable under ss CQ 2(2B) and DN 2 if the CFC qualifies for the active business exemption. While this income was not explicitly removed from reported passive in the numerator, it is unlikely to have been included in any of
the categories of attributable income using accounting measures as it is a creature of our tax law and not a measure of income by accounting standards.

The fourth adjustment is the removal of income or loss from a share that is not revenue account property. “Revenue account property” is defined in s YA 1. The income or loss may have been included in reported revenue so an adjustment is necessary for greater consistency with the tax measure of total income (gross income).

The fifth adjustment in s EX 21E(12)(e) is the removal of income derived by the CFC from a second CFC, if the second CFC could be part of a test group with the first CFC. This prevents the inflation of total income by arrangements between associates.

The sixth and seventh adjustments apply only when the applicable accounting standard is generally accepted accounting practice without IFRS. They apply to correct things recognised as revenue (eg a reduction of a provision or revaluations). The adjustment is intended to provide a closer approximation to tax measures of income.

Section EX 21E(13) sets out the conditions when accounts are taken to meet the requirements of the applicable accounting standard. This provision states that the accounts must meet the requirements of s EX 21C for the relevant accounting standard used for the purposes of calculating the active business ratio. In particular, s EX 21C(9) sets out the requirements that must be met. Effectively they are that the accounts state that they comply with the relevant standard, the accounts have received an unqualified audit opinion by an independent chartered accountant, and there are not reasonable grounds to suspect fraud, intent to mislead or incompetence.

Inland Revenue advises in their special report on the CFC rules issued in October 2009 that “strict compliance at a detailed level with the requirements of the standard will often not be practical, and an unqualified audit opinion will usually require compliance only in all material respects”. Thus, Inland Revenue accepts that this provision does not require strict compliance with the applicable standard.

Section EX 21E(13)(b) deals with the situation when information is not always directly available from the published accounts. For example, consolidated accounts for a corporate group may only provide information in a relatively aggregated form. When more detailed information is required, this may have to come directly from the CFC’s internal accounting systems or other similar sources.

Section EX 21E(13)(b) states that this information will still be taken to comply with the relevant accounting standard, as long as:

(a) It is drawn from compliant accounts (even though not appearing on the face of financial statements), or that was used to prepare compliant accounts; and

(b) The information is consistent with the compliant accounts; and

(c) There is no evidence of fraud, intent to mislead or incompetence.

850.58 Compliance with accounting standards [s EX 21C]

(1) Accounting standards test of determining the active business test

When using accounting standards to determine the ratio of a CFC’s attributable income to total income, it is first necessary to consider s EX 21C to determine whether accounting standards can be used. That is, while taxpayers have a choice as to whether they use the accounting standards measures or the default tax test, use of accounting standards is not automatic; it is necessary that the standards are permitted by s EX 21C. Further, if s GB 15C, which relates to the use of the accounting standards rules in s EX 21E to avoid tax applies, it is not possible to use accounting standards, and the rules in s EX 21D must be used.

Under s EX 21C there are three types of financial statements that may qualify:

(a) Generally accepted accounting practice with IFRS (ie New Zealand IFRS equivalents) [ss EX 21C(2) and EX 21C(3)];

(b) International financial reporting standard equivalents (IFRSE) (ie non-New Zealand IFRS equivalents) [ss EX 21C(4) and EX 21C(5)]; or
(c) Generally accepted accounting practice without IFRS (ie the old GAAP rules) [ss EX 21C(6) and EX 21C(7)].

Each of these requirements is discussed below. The one requirement that all three types of financial reporting standards must adhere to is that the accounts must be audited by an accountant who is a chartered accountant or an accountant of equivalent professional standard in the country in which the accounts are prepared, and the auditor must be independent of the CFC. It is also necessary that the accounts are given an unqualified opinion by the auditor [s EX 21C(8)].

A further overarching design feature is that only one type of financial statement may be used [referred to in the legislation as the “applicable accounting standard” — see s EX 21C(1)] for a CFC or a test group of CFCs. That is, features of all three types of financial statements permitted under s EX 21C cannot be cherry picked to give preferential outcomes for any one CFC or a test group.

(2) Generally accepted accounting practice with IFRS

Under s EX 21C(2) the interest holder may use generally accepted accounting practice with IFRS for a particular CFC if the person with the CFC interest or another person has accounts that:

(a) Include the accounts of that CFC;
(b) Comply with generally accepted accounting practice with IFRS; and
(c) The audit requirements in s EX 21C(8) are met.

The accounts may be for the CFC alone or for a group of companies that includes the CFC. In the latter case, further work will be required to separate (deconsolidate) amounts relating to the CFC in order to apply s EX 21E. The accounts may be held by the person who holds an interest in the CFC or by someone else.

The term “generally accepted accounting practice with IFRS” means generally accepted accounting practice, as defined in s 3 Financial Reporting Act 1993, but with a requirement that the New Zealand equivalents to International Financial Reporting Standards must be used as the financial reporting standards referred to in that section. These New Zealand standards (referred to as “IFRS” in s YA 1), are initially issued by the International Accounting Standards Board (IASB), then approved, with modifications, by the New Zealand Accounting Standards Review Board. Some entities qualify to use a subset of these standards (the “framework for differential reporting for entities applying the New Zealand equivalents to the international financial reporting regime”). That subset is also acceptable for the purposes of s EX 21E.

While the accounts must comply with generally accepted practice with IFRS, often absolute compliance is not practical. However, Inland Revenue advises that audited accounts will be treated as complying.

Section EX 21C(3) allows a person to use generally accepted accounting practice with IFRS for a “test group” of CFCs if accounts exist that include the accounts of the CFCs in the test group. The “test group” is defined under s EX 21E(2) as a group of CFCs a taxpayer has an income interest of more than 50 per cent and that are resident in the same country or territory and:

(a) The group consists of companies required to consolidate, whether or not with companies that are not in the group;
(b) Each company has the same functional currency; and
(c) There are audited and consolidated financial statements that include the accounts of the companies in the group and comply with the applicable accounting standards.

If the complying accounts also include the accounts of other entities, such as all the entities in a worldwide group, further work will be required to separate amounts relating to the test group when applying s EX 21E. The accounts may be held by the person who holds an interest in the CFCs in the test group or by someone else.

(3) International financial reporting standard equivalents

“IFRSE” is defined in s YA 1 as “an International Financial Reporting Standard approved by the International Accounting Standards Board, as amended from time to time”. Section EX 21C(4) allows the use of accounts that comply with international financial reporting standards. In contrast, s EX 21C(2) (discussed above),
allows the use of New Zealand equivalents to international financial reporting standards. In most respects, international financial reporting standards and the New Zealand equivalents to those standards are identical. However, that will not always be the case. Hence the fact that compliance with both IFRSE and the New Zealand equivalents is permitted.

Section EX 21C(5) allows a taxpayer to use IFRSE accounts for a test group of CFCs if accounts exist that include the accounts of the CFCs in the test group.

(4) Generally accepted accounting practice without IFRS

Section EX 21C(6) allows a company to use generally accepted accounting practice without IFRS for a particular CFC if specific requirements in that section are met.

The term “generally accepted accounting practice without IFRS” means generally accepted accounting practice as defined in s 3 of the Financial Reporting Act 1993, but with the restriction that the financial reporting standards referred to in that section must not be New Zealand equivalents to international financial reporting standards. Pre-IFRS New Zealand financial reporting standards (usually referred to as FRSs) is what the rules in ss EX 21C(6) and EX 21C(7) are referring to.

Allowing the use of pre-IFRS accounting standards is necessary because a large number of small and medium-sized entities are not yet required to comply with New Zealand equivalents to international financial reporting standards, pending completion of a review of financial reporting requirements by the government. These rules may well be temporary — they may be replaced, or repealed as the future of reporting requirements becomes clearer or as FRSs become outdated. The rules are not to be used when accounts that comply with IFRS are available [s EX 21C(6)(e)].

The requirements that must be met to use “generally accepted accounting practice without IFRS” are that a company that is resident in New Zealand must:

(a) Hold accounts that include the accounts of the CFC, that comply with generally accepted accounting practice without IFRS, and meet the audit requirements of s EX 21C(8);

(b) Not have revenue under either Financial Reporting Standard FRS-34 or Financial Reporting Standard FRS-35 (the intent is that insurance businesses will not be able to use generally accepted accounting practice without IFRS for the purpose of s EX 21E);

(c) Not be an issuer under s 4 of the Financial Reporting Act 1993 in the current accounting period and not have been an issuer in the preceding accounting period;

(d) Not be required by s 19 of the Financial Reporting Act 1993 to file its accounts with the Registrar of Companies;

(e) Not be a large company under s 19A(1)(b) of the Financial Reporting Act 1993; and

(f) Not have accounts (and not be a subsidiary of a company having accounts) that are prepared and audited under generally accepted accounting practice with IFRS (if such accounts are available, generally accepted accounting practice with IFRS should be used for the purposes of s EX 21E).

Most, but not all, of the requirements match those in Accounting Standards Review Board Release 9 (ASRB-9). ASRB-9 specifies the entities that are permitted to defer compliance with New Zealand equivalents to international financial reporting standards. However, as these requirements are set out in s EX 21C, in the event that ASRB-9 is withdrawn, amended or superseded, the requirements in the legislation will prevail for these purposes.

Section EX 21C(7) allows a taxpayer to use generally accepted accounting practice without IFRS for a test group of CFCs if certain requirements are met. The requirements are mostly the same as those in s EX 21C(6), except that the accounts must include the accounts of all the CFCs in the test group. If the accounts include the accounts of other entities, in addition to the CFCs in the test group, additional work will be required to identify and separate amounts relating to the test group.

(5) Compliance with accounting standards

Under s EX 21C(9) accounts are treated as complying with the relevant accounting standard if:
(a) The accounts state that they comply with the accounting standard;
(b) The accounts meet the audit requirements of s EX 21C(8); and
(c) The CIR does not have reasonable grounds to suspect:
   (i) Fraudulent activity by the interest holder, the CFC, a CFC in the CFC’s test group, or the auditor;
   (ii) Preparation of the accounts with an intent to mislead; or
   (iii) Incompetence of the auditor.

850.60 The Australian exemption [s EX 22]
A CFC qualifies to be a non-attributing Australian CFC if it is resident and subject to income tax in Australia. The CFC must also not be treated as being resident in another country under a double taxation agreement that Australia has with that other country.
A further requirement is that the CFC’s liability for income tax has not been reduced by an exemption for income tax for income derived from business activities carried on outside Australia or the CFC avails itself of any special allowance, relief, or exemption with respect to offshore banking units.
If the CFC is resident in Australia and meets all the other criteria of s EX 22, then no attributed CFC income or attributed CFC loss arises from the non-attributing Australian CFC. However, s EX 22 does not prevent the FIF look through rule operating. The look through rule applies to tax any FIF income (when FIF interests are held by a CFC) directly back to the persons with the CFC income interests [see 850.70].

850.65 CFCs in receipt of taxable distribution from non-qualifying trust [s EX 19]
When a CFC receives a taxable distribution from a non-qualifying trust, s EX 19 provides that:
(a) The taxable distribution is not taken into account in calculating the branch equivalent income or loss of the CFC;
(b) The taxable distribution is taxed directly to the person with an income interest in the CFC at 45 per cent (the rate in sch 1 of the ITA); and
(c) The amount to be taxed is calculated by multiplying the person’s income interest in the CFC for that accounting period by the amount of the taxable distribution.

Section EX 19 only applies if the person with the income interest in the CFC in receipt of the taxable distribution would have been required to calculate attributed CFC income or loss in respect of that income interest. Thus, s EX 19 will not apply if the CFC is an unqualified grey-list CFC or an income interest of 10 per cent is not held.
Although the amount of the taxable distribution is taxed at the rate applicable to such distributions from non-qualifying trusts, the amount calculated under s EX 19 is actually deemed to be attributed CFC income, referred to as “additional attributed CFC income”.

Note: The rules relating to taxable distributions from non-qualifying trusts differ to those relating to interests in FIFs held through a CFC, that will always attribute FIF income back whether the CFC is resident in an unqualified grey-list country or not. FIF income derived in these circumstances also retains its nature as such, and is not deemed to be additional attributed CFC income.

850.70 CFCs with interests in foreign investment funds [ss CQ 5(3), EX 21(33), EX 58]
When a person has an interest of 10 per cent or more in a CFC, that has an interest in a FIF, the FIF income or loss does not form part of the attributed CFC income or loss, and instead is calculated directly to the person with the income interest of 10 per cent or more in the CFC [see 850.210].
When any FIF income or loss is not taken into account in calculating net attributable CFC income or loss the person has FIF income or loss for their income year in which the accounting period of the CFC ends, calculated...
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by multiplying the income interest of the person in the CFC by the FIF income or loss calculated in respect of the CFC’s interest in the FIF.

Because the amount attributed to the person is be deemed to be FIF income or FIF loss of that person, the rules require that person to:

(a) Choose the calculation method for the FIF income or loss, as per the rules in ss EX 44 to EX 48; and
(b) Apply the calculation rules in ss EX 44 to EX 61 as though they held the FIF interest directly.

A further exclusion applies to any FIF that is a life insurer. As with the CFC rules, all income, profits and gains that are actuarially determined to be attributable to the policyholders are excluded from the CFC attribution rules. This exclusion is mirrored in s EX 58 when FIF income is calculated directly to the shareholders of the CFC.

Note: Section EX 21(33) contains three requirements that must apply when FIF income is to be excluded from net attributable CFC income or loss. These are:

(a) That the rights are not prevented from being an attributing FIF interest of the CFC because of the notional New Zealand residence given to the CFC by s EX 21(2) means that the FIF interest is actually an interest in a CFC of 10 per cent or more (see below for a further explanation);

(b) The FIF income or loss of the CFC in these circumstances is not taken into account in calculating the net attributable CFC income or loss; and

(c) Section EX 58 applies (discussed above).

The first of these three criteria (item (a) above), deserves a short explanation. Because the net attributable CFC income or loss is calculated as though the CFC were a New Zealand resident [s EX 21(2)], the interest of the CFC in the FIF could (notionally) be an interest in a CFC if it was an interest of 10 per cent or greater. Section EX 34 prevents an interest of 10 per cent or greater in a CFC from being a FIF interest. In effect, s EX 21(33)(a) provides that even if the notional residence of the CFC means that the CFC’s interest in the underlying company is an interest in a CFC, not a FIF, that will not on its own preclude s EX 58 from taxing the FIF income directly to the person with the interest in the CFC.

As with an income interest in a CFC, the FIF income or loss of a person who has ceased to be resident in New Zealand is treated as being derived while the person was a New Zealand resident (ie the income or loss is not apportioned further), as the period of non-residence is already taken into account in determining the income interest percentage applicable for the accounting period.

850.80 Calculation and attribution of CFC repatriation [ss CD 21, CD 45 to CD 52, CZ 10, GB 8]

The CFC attributed repatriation calculation rules were introduced to bolster the dividend withholding payment avoidance rule in s GB 39. The rules were targeted at arrangements to avoid the DWP rules by CFCs acquiring property in New Zealand that is made available for use by the New Zealand residents with interests in the CFC. The rules treated the increase in the New Zealand property amount of a CFC over its accounting period as a dividend. However, it could never exceed the amount of the unrepatriated income balance of the CFC.

These rules have been repealed for all income years beginning on or after 1 July 2009 by s 14 of the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 as part of the reforms to the international tax rules. As most foreign dividends are now exempt there is no need for the rule.

850.81 Calculating attributable CFC amount and net attributable CFC income or loss [ss EX 20B, EX 20C, EX 20D, EX 20E, EX 21]

Under the rules that apply from the 2010-2011 income year, only the passive income of a CFC is attributed back when the five per cent threshold ratio is breached, either for the CFC concerned, or for a group of CFCs (referred to in the legislation as the consolidated test group). If the five per cent passive income threshold is not reached nothing is attributed back. These CFCs are referred to in the legislation as non-attributing active CFC.
Even when the passive five per cent threshold rule is breached, only passive income of the CFC is attributed back, as set out in s EX 20B. This income attributed back to the New Zealand residents with income interests of 10 per cent or greater in the CFC and, and is determined by multiplying the person’s income interest in the CFC by the net attributable CFC income (formerly the branch equivalent income).

The rules are quite a complex labyrinth that requires determination of what the passive income amounts are and the calculation of whether the five per cent threshold has been breached.

(1) Definitions

“Attributable CFC amount” is a gross term used to define the items of passive income in s EX 20B that become taxable if the passive income threshold is breached.

“Attributed CFC income or loss” is the person’s income interest x the net attributable CFC income or loss [s EX 18].

“Net attributable CFC income or loss” is attributable CFC amount adjusted for funding costs and deductions under s EX 20C.

850.82 CFC signposting provision [s EX 18A]

The starting point in the CFC rules is s EX 18A, which is a signpost provision to the CFC calculations required. Section EX 18A(1) sets out the key components of the formula for the determination of the persons attributed CFC income or loss. It states that the attributed CFC income or loss of a person is found by multiplying the person’s income interest in the CFC by the CFC’s net attributable income or loss. Further this amount may be increased by any taxable distribution derived by the CFC for a non-complying trust as per the rules in s EX 19. A person’s CFC income or loss may be reduced is the provisions of s EX 20 apply to reduce any loss of the CFC to the economic loss suffered by the person.

Section EX 18A(2) provides that a person with an income interest (termed the interest holder in the legislation) in a CFC that has an attributable CFC amount under s EX 20B (that defines the passive income types that can be attributed back when the five per cent threshold rule is exceed) [see 850.95] has attributable income or loss equal to their income interest multiplied by the CFC’s net attributable income or loss as determined by ss EX 20C to EX 20E and the rules in s EX 21 and ss EX 24 to EX 27. However, no attributed CFC income or loss arises if the CFC is a non-attributing active CFC under s EX 21B or a non-attributing Australian CFC under s EX 22.

Section EX 18A(3) states that a non-attributing active CFC is determined under s EX 21B using the tests, as applicable, in ss EX 21D, EX 21E or EX 21C and the rules in s EX 21 and ss EX 24 to EX 27.

850.83 Attributable CFC amount [s EX 20B]

Section EX 20B defines what income is regarded as passive. This is the income of the CFC that must be attributed back if the five per cent threshold is breached. The broad categories of passive income are:

(a) Dividends;
(b) Interest (or financial arrangement income);
(c) Royalties;
(d) Rents;
(e) Other passive income (income from offshore life and general insurance businesses, life insurance policies, personal services and the disposal of revenue account property);
(f) Certain income relating to telecommunications services; and
(g) Base company income.

However, within these categories of passive income exemptions apply when the income is associated with an active business and there is limited risk to the New Zealand tax base.
The approach taken in s EX 20B(1) to determine the passive income that will be attributable, if the five per cent passive income threshold is exceeded, is to apply the rules in s EX 21 to the income amounts that comprise the formula:

\[ \text{gross + arrangement} \]

Where:

“Gross” is the total amount of income derived in the accounting period by the CFC that is one or more of the items outlined below.

“Arrangement” is discussed below [s EX 20B].

1. **Dividends [s EX20B(3)(a)]**
   - A dividend that is paid when the CFC has a direct income interest of less than 10 per cent in a foreign company and when one of the following FIF exemption rules applies [see 850.145]:
     - The Australian-resident listed company [s EX 31];
     - Australian resident unit trusts with adequate turnover or distribution [s EX 32];
     - Venture capital company exemptions [ss EX 36, EX 37 and EX 37B]; and
     - The terminating provisions for interests in Guinness Peat Group Plc [s EX 39].

   The above dividends received by CFCs from non-attributing portfolio FIFs are included in passive income, otherwise there would be no tax on these investments. This mirrors the position if the interests were owned directly by New Zealand residents.

2. **Dividends paid from New Zealand not fully imputed [s EX 20B(3)(b)]**
   - A dividend paid by a company resident in New Zealand that is not fully imputed. This ensures that these dividends will be taxed in full when attributed.

3. **Deductible or fixed rate dividends [s EX 20B(3)(c)]**
   - An amount that is a deductible foreign equity distribution or a distribution for fixed-rate foreign equity. These dividends are taxed as passive income to buttress the integrity of the tax system to avoid these dividends exposing the tax base to tax planning risk.

4. **Royalties [ss EX 20B(3)(d), EX 20B(5)]**
   - A royalty paid, as per the definition in s CC 9 [see 1290 ROYALTIES]. However, royalties are not regarded as passive income in situations when it is considered that there are valid commercial reasons for the intellectual property to be owned by a CFC. Thus, third party and related party royalties have been excluded when the CFC has created, developed or added substantial value to the property and when it can be shown that the CFC is regularly engaged in the creation or development of intellectual property. Additionally, the intellectual property should not have a prior link to New Zealand, thus ensuring the intellectual property is not relocated from New Zealand for tax purposes.

   Royalties that meet one of the following four conditions under ss EX 20B(5) are excluded from passive income.

   - The first condition excludes royalties that are third-party active royalties. The condition is that the CFC is regularly engaged in creating, developing or adding value to property that produces royalties and the royalty is:
     - Paid by a person who is not associated with the CFC under s YB 2;
     - From property not linked to New Zealand [s EX 20B(13)]; and
     - From property that the CFC has created or developed or to which the CFC has added substantial value.

   The second condition excludes royalties that are related-party active royalties. The condition is that the CFC is regularly engaged in creating, developing or adding value to property that produces royalties and the royalty is:


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(a) Paid by a person associated under s YB 2;
(b) From property not linked to New Zealand [s EX 20B(13)];
(c) From property that the CFC has created or developed or to which the CFC has added substantial value; and
(d) The amount of the royalty is an arm’s-length amount under s GC 13 [see 1000.70].

The third condition excludes royalties that are derived from within the same jurisdiction from an associated non-attributing CFC (which is defined in s YA 1 to be a related non-attributing CFC that is subject to the laws of the same country or territory as the other CFC). The condition is that the royalty is paid by a person who would be an associated non-attributing active CFC in the absence of ss EX 20B(5)(c), EX 20B(7)(c) and EC 20B(12)(a). This provision excludes royalties received by a CFC from a related CFC in the same jurisdiction when the related CFC would pass the active business test [see 850.84].

The fourth condition excludes royalties derived from intellectual property that is retained in New Zealand and licensed to a CFC, which may then sublicense the property to a third party offshore. The condition is that the royalty is:
(a) Paid to the CFC by a person not associated with the CFC under s YB 2, or by a CFC associated with the CFC under s YB 2 that has received a corresponding royalty payment from such a person; and
(b) From property owned by a New Zealand resident, who is not deemed for the purposes of a DTA to be resident in another country; and
(c) From property licensed to the CFC by the New Zealand resident for an arm’s-length amount under s GC 13.

(5) Rentals [ss EX 20B(3)(e), EX 20B(6), EX 20B(7)]

Rent from:
(a) A lease or sublease of land;
(b) A lease or sublease of personal property;
(c) A licence to use intangible property; or
(d) A hire or bailment.

As with royalties, rental income associated with an active business is excluded. For example, a CFC in the business of letting, or a CFC that leases property to a related CFC for the purposes of carrying on an active business.

The exclusions allow rent from third parties to be treated as active income if it is derived from a lease of real or personal property in the same jurisdiction as the CFC. The principle underlying this exclusion is that there should be a nexus between the jurisdiction in which the CFC is located and the source of income (e.g., the property from which the rents are derived) to prevent profits being sheltered from tax by shifting profits from a high tax jurisdiction to a low tax jurisdiction.

Section EX 20B(7) excludes rents from the definition of passive income in the following situations:
(a) Rent derived from land in a country or territory in which the CFC is liable to tax because of domicile, residence, incorporation or centre of management;
(b) Rent derived from property other than land to the extent to which the rent relates to the use of property in a country or territory in which the CFC is liable to tax because of domicile, residence, incorporation or centre of management; or
(c) Rent paid by a person who would be an associated non-attributing active CFC in the absence of ss EX 20B(5)(c), EX 20B(7)(c) and EX 20B(12)(a). This provision excludes rent received by a CFC from a related CFC when the related CFC would pass the active business test [see 850.100].

Payments under hire purchase agreements, finance leases and payments that fall within the definition of “royalty” under s CC 9 are not considered rent under the definition of passive income.
Furthermore, under s EX 20B(7)(g) a payment under a license to use intangible property that is not a royalty, or if it was a royalty would not be included in an attributable CFC amount under s EX 20B(5), is excluded from the definition of “rent”. The intent is that these license fees are treated in the same way as a royalty. Thus license fees that are not royalties are excluded if, had they been a royalty, they would have been excluded from the royalty rules [s EX 20B(5)].

(6) **Premiums derived by life and general insurers [s EX 20B(3)(f)]**

Income from a business of general insurance or life insurance that is a premium under an insurance contract or reinsurance contract.

This provision captures premiums from insurance contracts. Insurance premiums are captured as insurance contracts can be used to shift New Zealand-sourced income offshore. However, in many cases this type of income will form a core part of an active offshore insurance business. For this reason s EX 21B(3) deems an active insurance CFCs to be a non-attributing active CFC when Inland Revenue has made a determination to this effect under s 91AAQ of the TAA.

(7) **Distribution from a life insurance policy [ss EX 20B(3)(g), EX 20B(8)]**

A distribution of income from a life insurance policy if the income is not included in a calculation of FIF income or loss.

Income from a life insurance policy is included as passive income as it can be a substitute for investment returns. Note that income from a life insurance policy is probably targeting a distribution from a policy taken out in New Zealand as if the life insurance was a foreign policy of life insurance it would probably be FIF income. Thus, income from New Zealand insurance bonds, which is income under a life insurance policy, would be included under this category if derived by a CFC.

Income from “key person” insurance, when the CFC insures against the death or incapacity of a specified employee or member involved in the CFC’s business, is excluded from passive income provided it is not included in the calculation of FIF income or loss [s EX 20B(8)].

(8) **Income from the supply of personal services [ss EX 20B(3)(h), EX 20B(9)]**

Income from the supply of personal services if the personal services are performed by another person (referred to in the legislation as the working person), and:

(a) The working person is a New Zealand resident;
(b) The personal services are not essential support for a product supplied by the CFC;
(c) The working person is associated with the CFC under s YB 5 at the time the services are performed, or is a relative of that person at the beginning of the accounting period of the CFC;
(d) 80 per cent or more of the CFC’s total income in the accounting period from supplying personal services is derived through personal services of the working person in the circumstances discussed above, ie services that are not essential support for a product of the CFC; and
(e) To derive the income the CFC uses depreciable property that cost less than or equal to $75,000 or 25 per cent of the CFC’s total income from personal services derived in the accounting period.

This rule is based on that the domestic attribution rule found in ss GB 27 to GB 29 [see 740 INCOME ASSIGNED OR ALIENATED]. The domestic attribution rule is aimed primarily at situations when an entity is interposed into a de facto employer/employee relationship between a buyer and a working person in order to avoid the 39 per cent personal income tax rate. In the context of the CFC rules, the concern the rule in s EX 20B(3)(h) is addressing is the use of a CFC by a New Zealand resident to avoid tax on income from personal effort. The threshold for the top rate of personal income tax and the existence of employer/employee relationship are less relevant.

The only exception to the rules is when the services personally performed by the working person are essential support for a product supplied by the associated CFC. The provision is not intended to apply to income earned from services that are provided in relation to the sale of goods by a CFC. Therefore income from personal services is not treated as passive if the services are essential support for a product supplied by the CFC.
(9) **Revenue account property that is shares** [ss EX 20B(3)(i), EX 20B(10)]
Income from the disposal of revenue account property that is a share, except if the share is an attributing FIF interest and FIF income is calculated under one of the comparative value, deemed rate of return, fair dividend rate or the cost methods.

(10) **Revenue account property that is an option to acquire or dispose of a share** [ss EX 20B(3)(j)]
Income from the disposal of revenue account property that is an option to acquire or dispose of a share.

(11) **Income from the disposal of revenue account property that is not a share, financial arrangement or life insurance policy** [ss EX 20B(3)(k)]
Income from the disposal of revenue account property that is not a share, financial arrangement or life insurance policy, but rather is revenue account property that is used by the CFC with a purpose or effect of giving rise to income of the CFC referred to in another paragraph of s EX 20B(3). For example, a property held on revenue account that gives rise to rent under s EX 20B(3)(e).

(12) **Base company income rule** [ss EX 20B(3)(l)]
Income from a service, other than a telecommunication service, to the extent to which the service is physically performed in New Zealand. This source of passive income is also known as “base company income”. Much like the rule preventing the diversion of personal services income through a CFC at s EX 20B(3)(h), the base company income rule prevents the active income exemption being used to reclassify New Zealand-sourced income as foreign-sourced income. Arrangements which interpose a CFC between a service-performing entity in New Zealand and the party purchasing the service(s) could be used to achieve such a reclassification. Under the base company income rule, income derived by a CFC for a service that is wholly or partly performed in New Zealand is passive income of the CFC. Note that the rule specifically contemplates that the income attributable to the services performed in New Zealand can be apportioned. That is, if the services are only partially performed in New Zealand the amount paid for the services can be apportioned on a reasonable basis between the services performed in New Zealand and those performed outside New Zealand.

International telecommunications services are excluded from the base company income rule because of the difficulty of determining where a telecommunications service is performed, and because international telecommunications services have a logical connection with at least two jurisdictions.

(13) **Income from a service relating to the use of equipment to provide a telecommunications service** [ss EX 20B(3)(m)]
Income from a service relating to the use of equipment to provide a telecommunications service, to the extent to which the equipment is at the time:

(a) Physically located outside any country or territory; and
(b) Owned by a CFC or by another CFC that is associated with the CFC; and
(c) Not a mobile telephone handset or a radio receiver and transmitter for a ship or aircraft.

Income derived from the use of a telecommunications asset that is wholly or partly located outside any country will be passive income. Such income is of a character that it can be assigned to an arbitrary jurisdiction, and as such is considered passive. Where only part of the asset is located outside any country the rule contemplates that apportionment will be required.

Assets that will be subject to the rule above include, for example, submarine telecommunications cables, satellites, and associated plant and equipment. The types of income that will be derived from the use of such telecommunications assets include income from the transmission of telecommunications data using the asset; the lease of the asset; and the license or sale of rights to use the asset.
(14) Income from a telecommunication service to the extent to which the service is physically performed in New Zealand [ss EX 20B(3)(n), EX 20B(11)]

Income from a telecommunication service to the extent to which the service is physically performed in New Zealand. However, income from this source is not an attributable CFC amount if:

(a) The services is the transmission, emission, or reception of information between New Zealand and the country or territory in which the CFC is liable to income tax;

(b) The CFC is a network operator under the Telecommunications (Interception Capability) Act 2004, or a person who is a network operator under the aforementioned Act holds an income interest of 50 per cent or more in the CFC, or a person who holds a voting interest of 50 per cent or more in such a network operator holds an income interest of 50 per cent or more in the CFC;

(c) The service is not performed using equipment that at the time is physically located in New Zealand and in possession of the CFC or an associated CFC; and

(d) The service is not performed by a person who, at the time, is physically located in New Zealand and is an employee or contractor of the CFC or an associated CFC.

This provision clarifies the position taken in the base company income rule that income from the provision of telecommunications services is generally regarded as active income. However, subject to an exception for telecommunication services between the CFC’s jurisdiction and New Zealand, s EX 20B(3)(n) includes income from this source in passive income when the telecommunications service of the CFC is physically performed in New Zealand.

The exception to this rule, as mentioned, is provided in s EX 20B(11) and excludes telecommunication services between the CFC’s jurisdiction and New Zealand when the CFC is a network operator for the purposes of the Telecommunications (Interception Capability) Act 2004. The network operator can also be a person who holds a 50 per cent or more income interest in the CFC, or a person who holds a 50 per cent or more voting interest in a network operator and an income interest of 50 per cent or more in the CFC, thus accommodating the situation when the CFC and the network operator are under common control of a parent company.

Further, the exception applies only to the extent the telecommunication services between the CFC’s jurisdiction and New Zealand are not performed using equipment or staff of the CFC or of an associated CFC, that are located in New Zealand.

Note: The residence or source rules may in any event apply in this situation to tax the income derived in New Zealand.

(15) Arrangement [s EX 20B]

Section EX 20B(4) includes income from financial arrangements held by a CFC as passive income. It also includes income from a financial arrangement that is a short-term agreement for sale and purchase for which the CFC has made an election under s CW 8 to treat as a financial arrangement. However, in terms of s EX 20B(12), income from a financial arrangement that is not a derivative instrument (ie financial arrangement income referred to in s EX 20B(4)(a)) is not passive income if the financial arrangement is:

(a) A loan provided by the CFC to an associated active CFC in the same jurisdiction [see 850.100]; or

(b) An agreement for the sale or purchase of property or services or a hire purchase agreement that is entered in the ordinary course of business by the CFC, or for property or services produced or used in the CFC’s business.

Under s EX 20B(4)(b) income from financial arrangements that are derivative instruments is passive if the derivative instrument:

(a) Is held for the purpose of dealing in the derivative instrument;

(b) Is a hedge instrument of a type referred to in NZIAS-39 for passive income as defined in ss EX 20B(3) or EX 20B(4)(a);

(c) It is a derivative not entered in the ordinary course of the CFC’s business.
The term “ordinary course of business” is not defined. However, in the Official’s Report to the Finance and Expenditure Committee on the Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill 2008, it was pointed out that the matter had been discussed in a commentary on the adoption of IFRS for tax purposes in TIB vol 20:3 (April 2008). That commentary observed that:

“Facts and circumstances of a taxpayer’s business would determine whether a financial arrangement has been entered into in the ordinary course of the taxpayer’s business. For example, a taxpayer who borrows in a foreign currency, say in US dollars, to fund its subsidiaries in the US would most likely be considered to have entered into the loan as part of its ordinary course of business. A taxpayer who enters into a derivative contract to hedge a particular business risk would also be considered as having entered into the derivative contract in the ordinary course of its business. For example, an energy company may enter into contracts for differences to fix the price of electricity.”

Financial arrangement income arising under s EX 20B(4) is included on a gross basis — if there is income under the financial arrangement for the accounting period it is included, but if there is expenditure it is not. There is no “netting off” of expenses incurred, or of expenditure on similar classes of financial arrangement. However, financial arrangement expenditure may be allowed as deductions in calculating net attributable CFC income or loss.

850.84 Exclusions for rent, royalties and interest received from an associated CFC in the same jurisdiction [ss EX 20B(5)(c), EX 20B(7)(c), EX 20B(12)(a)]

Certain royalty, rent and financial arrangement income from associated active CFCs in the same jurisdiction as the CFC is excluded from passive income. However, in determining whether the status of the associated CFC is active, the royalty, rent or financial arrangement income from the associated same jurisdiction CFC is counted as passive income.

Example:
CFC’s Alco Ltd and Belco Ltd are 100 per cent commonly owned and are both resident in the same jurisdiction. When it applies the active business test, Alco Ltd has a numerator of $49,990 and a denominator of $1 million, but only if it can exclude royalties of $50,000 received from Belco Ltd. Belco Ltd has a numerator of $99,980 and a denominator of $2 million, but only if it can exclude financial arrangement income of $100,000 received from Alco Ltd.

Alco Ltd can only exclude the royalties if Belco Ltd is active, and Belco Ltd can only exclude the financial arrangement income if Alco Ltd is active, but neither CFC is active until it applies the exclusion.

To resolve this, when a CFC (Alco Ltd) determines the status of an associated CFC (Belco Ltd), it will do so without applying any of the exclusions to Belco Ltd. That is, for this purpose only, Belco Ltd’s status is to be determined assuming that any royalty, rent or arrangement income it receives from an associated CFC in the same jurisdiction is passive income.

Alco Ltd would determine that Belco Ltd’s numerator was $199,980 and its denominator was $2,100,000, meaning that Belco Ltd would not be active for this purpose. Alco Ltd would then have to recognise the $50,000 of royalties as passive income. Similarly, Belco Ltd would be required to recognise the $100,000 of arrangement income as passive income.

850.85 Net attributable CFC income or loss [ss EX 20C, EX 20D, EX 21]

The rules for calculating net attributable income or loss are set out in ss EX 20C, EX 20D and EX 21:

(a) Section EX 20C provides that net attributable CFC income or loss is to be calculated using a prescribed formula and lays down the main rules concerning the deductibility of expenditure.

(b) Section EX 20D makes special provision regarding the deductibility of interest expenditure for excessively debt-funded CFCs.

(c) Section EX 21 applies the Act (subject to certain modifications) for certain specified purposes, which include the calculation of net attributable CFC income or loss, as though a CFC were a New Zealand resident.

Non-interest expenditure will be deductible in calculating net attributable CFC income or loss to the extent it is incurred for the purposes of deriving an attributable CFC amount [s EX 20B] and not incurred for the
purposes of deriving a non-attributable amount. This is consistent with the nexus test that applies to non-interest expenditure incurred in deriving assessable income in the domestic context.

For most resident companies, there is no nexus test for interest expenditure. However, this will not be the case with a CFC in calculating the net attributable CFC income or loss. Deductions for interest expenditure incurred by a CFC will be based on the proportion of a CFC’s assets that are used to derive an attributable CFC amount. This is designed to address the risk that allowing a CFC to deduct all interest would mean that debt giving rise to interest deductions could be used to shelter attributable income.

To prevent offshore debt being concentrated in CFCs with mainly attributable assets, thereby sheltering attributable income, special rules apply to CFCs that are excessively debt funded. A CFC will be treated as excessively debt funded if its debt-to-asset ratio is more than 75 per cent and its relative debt-to-asset ratio is more than 110 per cent. In this case, the CFC’s interest deductions will be based on the overall asset mix of all the interest holder’s CFCs.

850.86 Net attributable CFC income or loss

The CFC’s net attributable CFC income or loss for the accounting period is calculated using the rules in s EX 21 and the formula:

\[ \text{attributable CFC} - (\text{limited funding costs} \times \text{fraction}) - \text{other deductions} \]

Where:

“Attributable CFC”, is the CFC’s attributable CFC amount determined under s EX 20B for the accounting period [see 850.95]

“Limited funding costs”, has two meanings depending on whether the CFC has on-lent funds to an associated CFC. If the CFC has not on-lent funds to an associated CFC limited funding costs is the total of the amounts for which the CFC would have a deduction in the accounting period that relates to financial arrangements that have provided funds to a CFC or to shares (held by New Zealand resident company or a CFC) that are fixed rate foreign equity or a share giving rise to a deductible dividend. That is, essentially the CFC’s borrowing costs. In legislative terms, these amounts are those referred to in s EX 20C(5)(a), that directs the reader to the definition of “funding” in s EX 20C(6), which then directs the reader to ss EX 20C(7)(a) and EX 20C(7)(b).

“Fraction” is defined in s EX 20C(8) and is the fraction of the attributable CFC’s assets (the taxable assets deriving the income to which s EX 20B applies) to the total CFC’s assets. If the CFC is not excessively debt funded under s EX 20D, “fraction” is determined by a formula in s EX 20C(10). If the CFC is excessively debt funded [s EX 20D], “fraction” is the lesser of the amounts determined under ss EX 20C(10) and EX 20D. Section EX 20D is discussed below.

Section EX 20C(8) defines the item “fraction” that is applied under the formula in s EX 20C(2) to restrict deductions for limited funding costs. Section EX 20C(10) to (12) and ss EX 20D and EX 20E are also relevant.

If the CFC wishes to take advantage of the on-lending concession that gives a full deduction for the interest paid by a CFC when funds are on-lent to associated CFCs, then the limited funding costs are reduced by the cost of the funds on lent by using the formula in s EX 20C(5)(b), which is:

\[ \text{funding costs} \times ((\text{funding} - \text{group funding}) / \text{funding}) \]

Where:

“Funding” is the funding costs of the CFC (the figure that would have been used in the absence of the on-lending concession) as discussed above.

“Group funding” is essentially the amount of the funds on-lent to an associated CFC that produces passive income [s EX 20B(4)] obviously this latter requirement is to ensure funds on-lent for no consideration do not qualify for the concession.

The formula in s EX 20C(10) that applies when the CFC is not excessively debt funded is:

\[ (\text{attributable CFC’s assets} - \text{group funding}) / (\text{total CFC’s assets} - \text{group funding}) \]

Where:
“Attributable CFC’s assets” refers to the total value of those assets that produce an attributable CFC amount (passive income). However, the definition excludes assets that do not produce an attributable CFC amount, which would appear to exclude an apportionment when an asset produces both attributable CFC amounts and non-attributable CFC amount.

“Group funding” is the same as that used in the formula in s EX 20C(5)(b), which is the amount of the outstanding financial arrangement balances that are on-lent to associated CFCs.

“Total CFC’s assets” is the total value of the CFC’s assets [s EX 20C(11)].

The other provision to have regard to for this formula is s EX 20C(12) that requires the debts and assets of the CFC to be measured having regard to the rules in ss FE 8 to FE 11 as if the CFC were an excess debt outbound company and the only member of the CFC’s New Zealand group.

(1) Other deductions

The amount of expenditure or loss (not being deductions relating to financial arrangements) incurred in the accounting period by the CFC to the extent it is incurred for the purposes of deriving an attributable CFC amount, and not incurred for the purposes of deriving an amount that is not an attributable CFC amount.

When the deduction relates to a financial arrangement, the deductible amount is the amount that exceeds the amount of “limited funding costs” in s EX 20C(5). This will allow the balance of the interest attributable to an amount on-lent to an associated CFC to be deducted.

If the deduction relates to a financial arrangement not taken into account in determining “limited funding costs” [s EX 20C(7)(a)], a deduction is permitted if the financial arrangement gives rise to an attributable CFC amount under s EX 20B(4). This could include for example, financial arrangements that are derivatives that do not provide funds to the CFC (as required by s EX 20C(7)(a)). For example a derivative instrument that is not entered into in the ordinary course of a business of a CFC [s EX 20B(4)(b)(ii)].

**Example 1 (no on-lending):**

A CFC has the following balance sheet as at the end of the accounting period:

<table>
<thead>
<tr>
<th>Capital</th>
<th>Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>$900,000</td>
<td>$1,100,000</td>
</tr>
<tr>
<td>Debt</td>
<td></td>
</tr>
<tr>
<td>$200,000</td>
<td></td>
</tr>
</tbody>
</table>

The CFC has an interest expense of $14,000, the assets of the CFC that relate to income that is an attributable CFC amount is $150,000. The CFC incurred other expenses in deriving the attributable CFC amount of $3,000. The attributable CFC amount is $12,000.

Applying the formula in s EX 20C(2) the net attributable CFC income or loss is:

\[
\text{net attributable CFC} = \text{attributable CFC} - (\text{limited funding costs} \times \text{fraction}) - \text{other deduction}
\]

Step 1 is determining the attributable CFC amount which is $12,000.

Step 2 is determining the limited funding amount (which is the total interest deduction if no on-lending). This is found by the formula

\[
\text{limited funding costs} \times \text{fraction} = 14,000 \times 0.14 = 1,960
\]

The net attributable CFC income is:

\[
12,000 - (1,960) - 3,000 = 7,040
\]

**Note:** In the absence of the requirement to limit the interest expenditure to the assets of the CFC that produce the attributed CFC amount, the result would be an interest deduction of $14,000, which would have given a loss (before other expenses) as we have used interest deductions on amounts used to derive both non-taxable active income and taxable passive income.

The formula has assumed that 14 per cent of the debt of $200,000 at a funding cost of seven per cent is deductible.

**Example 2 (on-lending):**

Using the figures in Example 1 (above), but we assume that $100,000 was on lent to an associated CFC. Thus, the interest holder can choose to use the formula in s EX 20C(5)(b) to determine the limited funding cost.
Again starting with the formula in s EX 20C(2):

\[
\text{attributable CFC} = (\text{limited funding costs} \times \text{fraction}) - \text{other deduction}
\]

Step 1 is determining the attributable CFC amount which is $12,000.

Step 2 is determining the limited funding amount. This is found by the formula:

\[
\text{funding costs} \times \left( \frac{(\text{funding} - \text{group funding})}{\text{funding}} \right)
\]

\[
= \$14,000 \times \left( \frac{\$200,000 - \$100,000}{\$200,000} \right)
\]

And thus limited funding costs of:

\[
(\$14,000 \times 0.5) = \$7,000
\]

Step 3 is determining the fraction. This differs from the fraction when there is no on-lending. This is derived from the formula in s EX 20C(10):

\[
\frac{\text{(attributable CFC’s assets} - \text{group funding})}{\text{(total CFC’s assets} - \text{group funding})}
\]

\[
= \frac{\$150,000 - \$100,000}{\$1,100,000 - \$100,000} = 0.05
\]

Applying the formula in s EX 20C(2):

\[
\$12,000 \times (\$7,000 \times 0.05) - \$3,000 + \$7,000
\]

\[
= \$12,000 - \$350 - \$10,000 = \$4,650
\]

Note: With on-lending the interest attributable to the on-lending, being $7,000 in our example, has been deducted in full under “other deductions” in s EX 20C(9)(b). Of the $200,000 of debt, $100,000 had been on lent and of the balance (under the formula) only $5,000 at our funding rate of seven per cent was deductible.

Further adjustments to the deductible interest are necessary when the CFC is excessively debt funded.

**850.87 Adjustment of fraction for excessively debt funded CFC [s EX 20D]**

Section EX 20D applies to modify the term “fraction” as used in calculating net attributable CFC or loss under s EX 20C(2) if the CFC is excessively debt funded.

The “fraction” used in s EX 20C(2) is based on the proportion, by value, of the CFC’s assets that produce an attributable CFC amount [s EX 20C(10) and (11)]. The “fraction” limits the deductibility of funding costs of the CFC to those funding costs that produce attributable CFC amounts. Thus, a CFC that uses one-third of its assets to earn attributable CFC amounts will be able to claim one-third of its funding costs when calculating its net attributable CFC income or loss. When an asset is used to derive both attributable and non-attributable amounts, its value will need to be apportioned. Asset values are adjusted to reflect any adjustment for on-lending under s EX 20C(5).

As a backstop against structures that concentrate debt in CFCs with mainly attributable assets in order to maximise allowable deductions, s EX 20C(8)(b) caps the fraction for a CFC that is excessively debt funded at the amount calculated under s EX 20D.

Under s EX 20D(2) a CFC is considered to be excessively debt-funded if it has a debt-asset ratio, determined under s EX 20D(4), of more than 0.75 and also has a relative debt-asset ratio, determined under s EX 20E (see below), of more than 1.10.

The formula in s EX 20D(4) is:

\[
\frac{\text{(total CFC’s debts} - \text{group funding})}{\text{(total CFC’s assets} - \text{group funding})}
\]

For the purposes of the above formula, the measurement rules in ss FE 8 to FE 11 apply to the CFC if the CFC were an excess debt outbound CFC [s FE 4] and the only member of the CFC’s New Zealand group.

Total CFC’s debts is defined in s EX 20D(6) to be the total amount outstanding at the end of the CFC’s accounting period, determined under generally accepted accounting practice, of the outstanding balances of financial arrangements entered into by the CFC that provides funds to the CFC and gives rise to an amount for which the CFC would have a deduction. The definition also includes fixed rate foreign equity issued by the CFC (and held by a New Zealand resident or another CFC) and shares issued by the CFC that give rise to deductible distributions to a New Zealand resident company or another CFC.

Total CFC’s assets is the total value of the CFC’s assets determined under generally accepted accounting practice.
Group funding is the lesser of the total CFC’s debts (as discussed above) and the total of outstanding balances for financial arrangements that provide funds to an associated CFC [s YB 2] and which produce “arrangement income” [s EX 20B(4)]. The item group funding allows for on-lending.

If a CFC is excessively debt funded, that is if its debt-asset ratio is more than 0.75 and also has a relative debt-asset ratio, determined under s EX 20E (discussed below), of more than 1.10, then the item “fraction” in s EX 20C(2) is determined by the formula in s EX 20D(10):

\[
\frac{\text{attributable CFC assets}}{\text{total CFC assets}}
\]

Where:

“Attributable CFC assets” is the total value of assets (consolidated under generally acceptable accounting practice) for all of the interest holder’s CFCs and the accounting period when each asset is used to derive an attributable CFC amount and not used to derive an amount that is not an attributable CFC amount.

“Total CFC assets” is the total value of assets (consolidated under generally acceptable accounting practice) for all of the interests holder’s CFCs and the accounting period.

The above formula thus looks at all of interest holders CFC interests and looks at the debt to asset ration of the interest holder’s aggregate CFC assets that produce attributable CFC amounts compared with the total CFC assets. This means that item “fraction” used for s EX 20C(2) is based on the taxable CFC assets of all of the New Zealand resident’s CFC’s.

850.88 Relative debt-asset ratio for CFC [s EX 20E]

This section applies to determine if the CFC has a relative debt-asset ratio of more than 1.10.

It does this by comparing the group debt-asset ratio for the CFC’s group and comparing that with the debt asset ratio of the CFC.

For this purpose s EX 20E(2) sets out who the members of the CFC’s group are. The group members are the CFC and the members of the world wide group that the interest holder would have:

(a) Under ss FE 31B, FE 31C and FE 32, if the interest holder is a company;

(b) Under s FE 3(1)(b) if the interest holder is a trustee; and

(c) Under s FE 5(1C)(a) to (c) if the interest holder is a natural person.

The formula for calculating the CFC’s group debt to asset ratio is contained in s EX 20E(3). The formula is:

\[
\frac{\text{total group debts}}{\text{total group assets}}
\]

Where:

“Total group debts” is the total amount outstanding at the end of the CFC’s accounting period, consolidated under generally accepted accounting practice for the CFC’s group, of the outstanding balances of financial arrangements entered into by the group’s members that provides funds to the CFC and gives rise to an amount for which a group member would have a deduction. The definition also includes fixed rate foreign equity issued by a member of the group (and held by a New Zealand resident or another CFC) and shares issued by a member of the group that give rise to deductible distributions to a New Zealand resident company or another CFC.

“Total group assets” is the total value of the group’s assets consolidated under generally accepted accounting practice.

The group debt to asset ratio is then compared to the CFC’s debt to asset ratio, by dividing the CFC’s debt to asset ratio [s EX 20D(4)] by the group debt to asset ratio [s EX 20E(3)].

850.90 Attributable CFC amount and net attributable CFC income or loss [s EX 21]

With the changes to the CFC rules to tax only the passive income of a CFC when the active business test is breached, the rules in s EX 21 are now used for three purposes:

(a) First, to calculate the attributable CFC amount for a CFC under s EX 20B;
Secondly, to calculate net attributable CFC income or loss for a CFC under s EX 20C; and

Thirdly, in determining whether a CFC is a non-attributing CFC for the purposes of the rules in s EX 21D — that calculates the active business test ratio using tax concepts. For this purpose, s EX 21(1B) states that for the purposes of determining whether a member of a group of CFC’s is a non-attributing CFC, s EX 21 is used to calculate the consolidated annual gross income of the group, and the consolidated attributable CFC amount of the group is also to be calculated under the rules in s EX 21.

The rules in s EX 21 start from the general premise that the attributed CFC income or loss of any CFC for any accounting period shall be the amount that is equal to the income or loss that would be calculated for that foreign company were that foreign company at all times in that accounting period a New Zealand resident company. However, the rules in s EX 21 make a number of modifications to take into account the fact that the CFC is actually resident in a foreign country or to deal with the peculiarities of the CFC rules. Thus, calculating the attributed CFC income or loss of the CFC essentially requires restatement of the CFC’s income tax position to that which would have been the case if the CFC had been subject to New Zealand tax law, as modified by the rules in s EX 21.

When the attributed CFC income or loss figure is determined, that figure is then used in the s EX 18 formula to determine the persons net attributed CFC income or loss.

The specific rules that apply (to modify the general rule that the calculations are undertaken as though the CFC were a New Zealand resident) to calculate the attributed CFC income or loss are outlined below.

(1) Currency conversion [s EX 21(4)]

The taxpayer must choose under s EX 21(4):

(a) For all calculations to be done in New Zealand dollars; or

(b) For all calculations to be done in the currency in which the CFC prepares its financial accounts or, if it does not prepare such accounts, in the currency of the country or territory in which the foreign company is resident. The result is then converted into New Zealand currency at the average of the close of trading spot exchange rates for the 15th day of each complete month falling within that period.

“Close of trading spot exchange rate” for any foreign currency on any day [s YA 1] means:

(a) The rate of a spot contract for the purchase of New Zealand dollars using the foreign currency at any time on that day on a market approved, and obtained from the sources of information approved, by the CIR in Determination G6D (or any substitute determination) made under the financial arrangement rules and if no such rate can be ascertained for that day then such a rate on the next succeeding day (before a day not later than five working days after that day) upon which such a rate is able to be ascertained;

(b) If, for any foreign currency, no such rate of a spot contract can be so ascertained, the cross rate determined as at 3 pm NZST on that day by applying the method outlined in paragraph 6(3)(c) of the Determination G6D (or any substitute determination); or

(c) If paragraphs (a) and (b) above do not apply, then the rate determined by applying the method specified in paragraph 6(2) of Determination G9A (or any substitute determination).

Once a particular currency has been adopted by a taxpayer for calculating the attributable CFC amount and net attributable CFC income or loss, the same currency must be used by the taxpayer in all subsequent accounting periods for that CFC. The CIR may approve a change in the currency used if the change is for commercial reasons (other than reducing tax), and the change does not have the purpose or effect of defeating the international tax rules [ss EX 21(5) and (6)].

(2) Financial arrangements [s EX 21(7)]

The rule in s EX 21(7) applies to require financial arrangements to be expressed in New Zealand currency. The rule in s EX 21(7) overrides the rules in s EX 21(4) to (6). This is to stop CFCs that are associated persons
from entering into related-party financial arrangements when the currency of the respective CFC’s differs, thus giving different results depending on what currency is used by the CFCs.

Section EX 21(7) states that ss EX 21(4) to EX 21(6) do not apply to the calculation of attributable CFC amount and net attributable CFC income or loss from a financial arrangement if:

(a) The total value of all financial arrangements to which the CFC is a party, calculated under s EW 17(2)(b) (straight-line method) on any day during the accounting period, is more than $1 million; or

(b) The amount that would be the CFC’s total net foreign exchange loss for the accounting period, if the amount were calculated under s EX 21(4) to (6), for all financial arrangements to which the CFC is a party on any day during the accounting period, is more than $100,000.

In this case, the financial arrangement rules apply to measure the income or loss attributable to the financial arrangement as though the CFC were resident in New Zealand. As a compliance measure, this exclusion does not apply to a variable principal debt instrument if (essentially the bank account of the CFC):

(a) All rights and obligations under the instrument are expressed in the same currency as that used to calculate CFC income or loss; and

(b) No party to the instrument is associated with the CFC or enters into the instrument under an arrangement to defeat this limitation.

Inland Revenue has specified exchange rates acceptable for converting foreign currency amounts into New Zealand [see 760.25 and 850.220].

(3) Cost base of tangible assets [s EX 21(9) and (10)]

The cost at the beginning of the period of premises, plant, machinery, equipment, and trading stock shall be:

(a) The value at the end of that immediately preceding period as was used for the attributed foreign income or loss calculation for the immediately preceding period if the person for whom the calculation is being made had any attributed foreign income or loss for an income interest in that CFC for the immediately preceding period; or

(b) If the person did not have any attributed foreign income or attributed foreign loss for the immediately preceding period in that CFC, then at the option of the person, either:

(i) The historical cost of the asset less accumulated depreciation (if any) or other value used by the foreign company as the commencement value for that period for the purposes of income tax calculations in the country in which that foreign company is resident (being a value not higher than the market value of the asset at the beginning of that period); or

(ii) The value that would be used at the beginning of that period calculated as if the CFC had at all times been a resident.

(4) Cost base of financial arrangements [s EX 21(11)]

If the person did not have attributed foreign income or an attributed foreign loss from an income interest in the CFC for a period immediately preceding the accounting period, the consideration under the financial arrangement rules for a financial arrangement is calculated at the beginning of the accounting period and is, at the person’s option, either:

(a) The market value of the financial arrangement; or

(b) The absolute value of the result of the formula:

\[
\text{consideration paid to the CFC + expenditure} - \text{consideration paid by the CFC} - \text{income}
\]

Where:

"Consideration paid to the CFC" is the consideration paid to the CFC for all periods before the accounting period;

"Expenditure" is the expenditure that would have been incurred under the accrual rules for all periods before the accounting period as if the CFC had been resident in New Zealand;
“Consideration paid by the CFC” is the consideration paid by the CFC for all periods before the accounting period; and
“Income” is the income that would have been derived under the accrual rules for all periods before the accounting period as if the CFC had been resident in New Zealand.

(5) **Provisions of the ITA 2007 that do not apply** [s EX 21(13)]

The following provisions shall not apply in the calculation of branch equivalent income:

(a) The consolidation rules;

(b) Section CB 27 (income equalisation schemes) and subpart DQ (income equalisation schemes and environmental restoration accounts schemes) and subpart EH (income equalisation schemes);

(c) Sections CD 45 to CD 52 (which relate to the CFC attributed repatriation calculation rules) or subpart CQ (attributed income from foreign equity) or subpart DN (attributed losses from foreign equity) or this subpart to the extent to which any of the sections or subparts would result in attributed CFC income, attributed CFC loss, or attributed repatriation for the CFC;

(d) Section CW 8 (money lent to Government of New Zealand);

(e) Section CW 9 (dividends derived from foreign company);

(f) Section CW 10 (dividend within New Zealand wholly-owned group)

(g) Section CW 40(1) (local and regional promotion bodies);

(h) Sections DO 1 (enhancements to land, except trees) and DO 2 (erosion and shelter plantings);

(i) Sections EW 9 (persons to whom financial arrangements rules apply) and EW 11(b) (what financial arrangements rules do not apply to);

(j) Subpart FE (interest apportionment on thin capitalisation);

(k) Section GB 5 (arrangements involving trust beneficiaries); or

(l) Sections IA 2 to IA 9, subpart IC, and ss IP 3 to IP 7, IZ 4, and IZ 5 (which relate to the use of tax losses).

(6) **Provisions of ITA 2007 that do apply to the CFC as if the CFC carried on business in New Zealand** [s EX 21(14)]

The following provisions do apply in the calculation of the branch equivalent income as if the CFC’s business activities were carried on in New Zealand:

(a) Sections CT 1 to CT 3, CT 5 to CT 7, CX 42, CX 43, CZ 8, DT 1 to DT 15, DT 17 to DT 19, and IS 5 (which relate to petroleum mining):

(b) Sections DO 4 to DO 7, DO 12, DP 1 to DP 3, DP 8, and DP 11 (which relate to farming, aquacultural, and forestry expenditure):

(c) Section EZ 16 (amount of depreciation loss for plant or machinery additional to s EZ 15 amount):

(d) The definitions in subpart YA (general definitions) that specifically apply for the purposes of those sections.

(7) **Transfer pricing rules** [s EX 21(15)]

When a transaction has been entered into between a CFC and an associated party has the purpose or effect of defeating the intent or application of any of the jurisdictional ring-fencing rules, the rules set down in ss GC 6 to GC 14 shall apply with any necessary modifications. That is, the transfer pricing rules only apply to transactions that have a purpose or effect or defeating the jurisdictional loss and tax credit ring-fencing rules in ss DN 4, IQ 2, IQ 4, and LK 1 to LK 7.

(8) **Treatment of dividends** [ss EX 21(16)]

Dividends that are not part of the CFC’s attributable CFC amount are exempt income of the CFC.
(9) **Benefits from money advanced** [s EX 21(18)]
When s CC 7 (consideration other than money) is applied, that money advanced shall be assumed to be used for a business carried on in New Zealand by the borrower.

(10) **No tainting by association under the land sales rules** [s EX 21(19)]
Sections CB 9 to CB 13 and CV 1 shall not apply to treat any profits or gains as income if those profits or gains would not be treated as income except for the nature of the activities undertaken by associated persons of the CFC when those persons are not residents.

(11) **Crown acquisition of land** [s EX 21(20)]
The reference in s EI 8(1) to the Crown are assumed to include the Government of any country or territory other than New Zealand.

(12) **Depreciation loss recovered** [s EX 21(21)]
When ss EE 48 to EE 52 (which relate to the disposal of assets) are applied, then the CFC shall be assumed to have been allowed a depreciation deduction, and to have an adjusted tax value accordingly, if an amount of depreciation loss for any asset has been deducted when calculating the branch equivalent income or loss of the CFC for any period.

(13) **Accounting for GST** [s EX 21(22)]
In accounting for GST, references to output tax, input tax, or goods and services tax payable shall apply to similar concepts for any value added or other similar tax, in a country or territory other than New Zealand.

(14) **Government grants** [s EX 21(23)]
In accounting for subsidies and grants, reference to the Government of New Zealand shall include the Government of any foreign jurisdiction and payments of subsidies or grants shall be income if that would be the situation if they were derived by a resident company.

(15) **Subvention payments** [s EX 21(24)]
If an amount is paid as consideration for the transfer of tax losses, it is income derived by the CFC. However, it is only deductible if paid by the CFC to a person resident in the same country or territory as the CFC and not a non-attributing active CFC and provided it is deductible under the law of that country.

(16) **Life insurers** [ss EX 21(25) to (27)]
In calculating the net attributable CFC income or loss of any CFC that carries on the business of providing life insurance or in which any shares are held directly or indirectly by a foreign company (the parent) that carries on the business of providing life insurance, the life insurance rules do not apply. Instead, the net attributable CFC income or loss is actuarially determined to be the part of the CFC’s net income or loss to which the shareholders (and not the policyholders) are entitled. Exceptions apply when the CIR considers that the amount is not a reasonable reflection of the relevant profit or loss, or when sufficient information has been requested but not been received to enable the CIR to review the actuarial calculation.

(17) **Mineral and petroleum mining** [ss EX 21(28) and (29)]
The provisions applicable to a CFC carrying on mining activities or petroleum mining activities outside New Zealand are substantially the same as applicable in New Zealand.

(18) **Finance leases** [ss EX 21(30) and (31)]
No leases entered into by the CFC before the start of the first accounting period for which that company was a CFC shall be a finance lease or a specified leases, except if the finance or specified lease or leases are entered into between that company and any other CFC or a New Zealand residents.
(19) **Taxable distributions from non-complying trust** [s EX 21(32)]

When the CFC has received a taxable distribution under the trust regime, it shall not be taken into account in calculating the net attributable CFC income or loss of the CFC as a taxable distribution, but shall be accounted for under s EX 19 [see 850.65].

(20) **CFCs with FIF interests** [s EX 21(33)]

When the CFC would, if it were a resident, have an attributing interest in a FIF:

(a) No FIF income or FIF loss shall be taken into account in calculating the net attributable CFC income or loss; and

(b) Section EX 58 shall apply for such FIF income or loss.

This is also discussed at 850.70.

(21) **Transitional treatment of cross-border reinsurance** [s EX 21(34)]

Section CZ 12 (General insurance with risk period straddling 1 July 1993) applies as if the reference to New Zealand were a reference to the CFC’s country of residence.

850.95 **Foreign tax credits** [ss LJ 7, LK 1, LK 2, LK 3, LK 4, LK 5, LK 6, LK 7]

Section LK 1 sets out the broad rule that applies to tax credits relating to attributed CFC income. It provides that a person who has an amount of attributed CFC income shall be allowed a tax credit against the New Zealand income tax payable on that attributed CFC income. The tax credit is equal to the following amounts paid or payable in relation to the attributed CFC income:

(a) An amount of income tax paid by the CFC from which the income is derived;

(b) An amount of tax withheld and paid on behalf of the CFC from which the income is derived;

(c) An amount of foreign income tax paid by the CFC from which the income is derived; or

(d) The amount of foreign tax paid by the person under legislation of another country or territory that is the equivalent of the international tax rules:

A credit thus arises for the income tax imposed on that CFC in New Zealand, or any other country or territory in relation to attributed CFC income. This includes any withholding tax imposed on that CFC. If income tax is imposed in a country or territory outside New Zealand, on the New Zealand resident shareholder with an income interest in the CFC (as opposed to the CFC), the New Zealand resident with the attributed CFC income, can claim this tax as a credit.

Under s LK 3, if the income tax imposed on the CFC is paid or payable in a currency other than New Zealand currency it shall be converted into New Zealand currency at the option of that person either:

(a) By applying the close of trading spot exchange rate applicable on the date when the income tax was paid or became payable; or

(b) By applying the average of the close of trading spot exchange rates for the 15th day of each complete month falling within that period.

Inland Revenue has specified exchange rates acceptable for converting foreign currency amounts into New Zealand [see 760.25, *Brooker's Tax Rates Guide 10-900*].

For the purposes of s LK 1(1), the amount of the tax credit in respect of the attributed CFC income of any person is the product of the income interest used to calculate attributed foreign income and the income tax imposed on the CFC in any country or territory (including New Zealand) for that accounting period. A credit against income tax payable in New Zealand is not allowed for income tax paid or payable in the countries or territories specified in sch 27. No countries or territories are currently specified in sch 27 [s LK 2]. This is then claimed as a credit against the attributed CFC income and is limited to the income payable on that attributed CFC income — calculated as though that was the only income derived in that income year [s LK 1(3)].

Under s LK 1(3) a person entitled to a tax credit shall only be entitled to claim the credit against:
International Tax Regime

(a) Income tax payable for attributed CFC income derived by that person in that income year for that CFC; and
(b) Income tax payable for attributed CFC income derived by that person in that income year for any other CFC resident in the same country or territory in which the first-mentioned CFC was resident giving rise to the credit.

So far as it can not be so deducted or set off, the credit may be carried forward to the immediately succeeding income year under s LK 4, or transferred within the group of companies under s LK 6, subject in both cases to jurisdictional ring fencing.

If the person who has any credit allowable is a company, then under s LK 5 that credit may only be carried forward to any succeeding income year if and to the extent to which, had that credit been a loss, the carry forward of that loss would have been permitted and that credit shall be deemed to be a loss incurred on the last day of the income year for which the credit was initially allowable.

The tax credit rules for CFCs in subpart LK are also applied to branch equivalent FIFs by ss EX 50(8) and EX 50(9).

With the changes made in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009, transitional rules have been inserted to deal with any remaining tax credits arising under the branch equivalent CFC rules. This is because the attributed CFC income under the new rules is calculated from a different base (passive income) to that used for the full branch-equivalent (BE) calculation used in the former rules, and thus any remaining tax credits need to be put on an equivalent footing.

In broad terms, the effect of these rules is that foreign tax credits accumulated under the old rules can be carried forward into the new system, but will be modified by the transitional rule in s LK 5B. The transition rule applies when:

(a) A person has a tax credit arising under the old branch equivalent rules (the available BE credit); and
(b) The BE credit relates to a CFC or FIF that is resident in a jurisdiction in which the credit arose; and
(c) The BE credit is carried forward to the first year of operation of the new rules (referred to in the legislation as the conversion year).

The credit relating to a jurisdiction carried forward under the previous rules is the available BE credit for that jurisdiction. The amount of available BE credit converted each year is the converted BE credit, which under s LK 5B(2)(a)(ii) is no longer available to be carried forward. Under s LK 5B(2) each year some or all of the available BE credit is converted into an equivalent tax credit, which is effectively treated as an ordinary credit under subpart LK.

A person has two choices. They can elect under s LK 5B(3) by giving a notice (in a form and at a time acceptable to the Commissioner) that the available BE tax credit (the historical credits) not be carried forward. The other alternative is to apply the provisions of ss LK 5B(4) to LK 5B(7) to convert the BE credits into an equivalent tax credit that is then effectively treated as an ordinary credit under subpart LK.

The approach is the same as that taken for losses under s IQ 2B (as discussed above). An election to fix the jurisdictional income ratio using the average ratios over a two-year period under s IQ 2B(8) also applies for tax credit purposes. As for losses, a person may also use net profit or losses from accounts, instead of BE income or loss, when determining the jurisdictional BE income [s LK 5B(8)].

The definitions of jurisdictional attributed income, jurisdictional BE income, jurisdictional income ratio and resident group member used in s LK 5B are located in s IQ 2B(9).

Example:
A person’s income tax liability in relation to their jurisdictional BE income is $400. The person’s available BE credit is $1,200. The tax liability on the person’s jurisdictional attributed income is $125. The jurisdictional income ratio is 3.2. Using the provisions of s LK 5B(4), the person’s converted BE credit is the lesser of $400 and $1,200, being $400. The person’s equivalent tax credit is the lesser of $125 and $375. Thus, the person will have a tax credit of $125 for the year, and will reduce their available BE credits by $400, leaving a BE credit to carry forward of $800.
850.100 Taxable distribution giving rise to attributed foreign income

When any CFC receives a taxable distribution, and for any person with an income interest of 10 per cent or greater in that CFC a taxable distribution gives rise to additional attributed CFC income, then a credit against income tax payable in New Zealand for that additional attributed CFC income shall be allowed only for any tax paid that is substantially of the same nature as NRWT.

The amount of the tax for which a credit is allowed for the additional attributed CFC income shall not exceed an amount calculated in accordance with the following formula:

\[
\text{person’s taxable distribution / total distribution} \times \text{foreign tax paid}
\]

Where:

“Person’s taxable distribution” is the amount of the taxable distribution derived by the CFC (including the tax which qualifies for the credit);

“Total distribution” is the total amount of the distribution (including the tax which qualifies for the credit);

“Foreign tax paid” is the amount of the foreign withholding tax that qualifies for the credit under s LK 7(2).

850.105 Refunds of income tax paid and tax credits

When a tax credit has been allowed against New Zealand income tax payable by any person, which has not taken into account any refund, amount, or benefit (determined directly or indirectly by reference to some or all of the payment of foreign income tax) received by the person that has not been taken into account in calculating the income tax liability, then under s LJ 7(3) the person is liable to pay the CIR the lesser of the refund of foreign tax or the amount of New Zealand tax payable on the foreign income calculated under s LJ 5. The date for payment is the later of the date the refund is received or 30 days after the date on which the person’s return of income for that year is filed. The refund is treated as having been received, whether it is received by the person or a person associated with person who paid the tax or a person associated with either person.

Note: The provisions of s LJ 7, apply from the 2008-2009 and later income years. Prior to this the rule, as it applied to tax credits against attributed foreign income, differed. Previously, in these circumstances, the amount of that excess (refund) was applied to reduce the balance of any tax credits carried forward for that CFC and to the extent that the amount of the excess is not applied to reduce the balance of the tax credits carried forward for that CFC, that excess shall be deemed to be income tax due and payable to the CIR on the 30th day after the date of the notice of assessment in which the credit is reflected or the date of the receipt by the CFC of that refund or repayment, whichever date is the later.

850.110 Group of companies’ foreign tax credits

When a company (company A) has for any income year a credit allowable for an income interest in a CFC (company B), or has carried forward to that income year such a credit, and that credit may not be utilised by the company A in that income year, then that credit may, so far as it extends, be allowed against income tax payable in New Zealand on attributed CFC income derived for that income year by any other company (company C) where that other company is a member of the same group of companies as the first company.

However, any credit to which this provision applies may only be allowed against income tax payable by company C on attributed CFC income derived from any CFC resident in the same country or territory as that in which company B was resident in the accounting period in which the income tax giving rise to the credit was paid or payable.

The tax credit rules also require the loss grouping requirements to be met before a tax credit can be offset by a company within the group. Specifically, s LK 6(4) states that company A may make an amount of a tax credit available to company C to use only if the amount would be able to be used under subpart IC (Grouping tax losses), reading the subpart by substituting:

(a) A wholly-owned group of companies for a group of companies;

(b) A credit of company A for a tax loss component of the loss company;
(c) The use of the credit to satisfy an income tax liability for the use of a tax loss component to reduce net income, in both subpart IC and s GB 4 (arrangements for grouping tax losses: companies);
(d) Company C for the company B
(e) The income tax liability of company C for the net income of company B; or
(f) Sections LK 1 to LK 5 for ss IA 3 to IA 5 (which relate to the use of tax losses generally).

Note: Among other things this restricts the tax credit group offset to wholly-owned groups.

**850.115 Change of CFC’s accounting date** [s EX 25]

If a person has an income interest in a CFC, and has calculated CFC income or loss, or attributed repatriation from the CFC on the basis of an accounting year (referred to as the old accounting year), and wants to use a different accounting year (the new accounting year) for the calculations, the person may make the change only with the approval of the CIR.

However, if the new accounting year ends in a later income year of the person than the old accounting year ends in, and that would result in attributed CFC income or attributed repatriation being derived in that later income year, that amount is not deferred to the later income year and instead is treated as derived in the previous income year. This rule applies only in the year of transition.

The CIR may consider any relevant factors in determining whether to approve a change, including:
(a) Whether the election results from a change in ownership of the foreign company;
(b) Whether the election results from the requirements of taxation or other laws of any jurisdiction in which the foreign company is resident or carries on business;
(c) Whether the election results from the requirement to have consistency in the accounting year balance dates of a group of companies; and
(d) Whether the election, if approved, would result, in any income year, in a postponement of liability to income tax on attributed CFC income, or to income tax or dividend withholding payment on an attributed repatriation dividend.

**850.120 Attributed foreign losses** [ss DN 1, DN 2, DN 3, DN 4, EX 20, IQ 2, IQ 4, IQ 9; TAA, s 92]

Under s DN 1, a person is allowed a deduction for an attributed CFC loss. This is subject to the jurisdictional ring-fencing rules in s DN 4. The rules in s DN 4 provide that if a person has an attributed CFC loss for an income year, a deduction is allowed for that year of no more than the total of:
(a) Any attributed CFC income in the income year for any other CFC resident in the same country as that in which the first-mentioned CFC was resident in the accounting period during which the attributed foreign loss arose; and
(b) Any FIF income calculated under the branch equivalent method derived by the person in the income year in respect of any FIF resident in the same country.

A person may only take an amount of attributed CFC income or FIF income for an income year into account to the extent that the person has not taken the amount into account in any other calculation for any other attributed CFC loss or FIF (branch equivalent) loss [s DN 4(2)].

If in an income year an attributed CFC loss of a person exceeds the amount allowed as a deduction as per the rules above, that amount becomes an attributed CFC net loss and able to be used under ss IQ 2, IQ 2B, IQ 4 and IQ 9: offset against net income in a future income year or against net income of another company in the current income year or in a future income year [s DN 4(3)].

Under s IQ 2, a person is allowed a deduction for an attributed CFC net loss carried forward that is no more than the total of:
(a) Any attributed CFC income of the taxpayer for that income year for:
   (i) The CFC for which the loss arose, if that company remains resident in the same country; and
(ii) Any other CFC resident in the same country; and

(b) Any FIF income calculated under the branch equivalent method, of the taxpayer derived in that
income year for any FIF resident in the relevant country.

A person may only take an amount of attributed foreign income or an amount of FIF income into account to
the extent it has not been taken into account elsewhere. When a person has an attributed CFC net loss and
(under s 38 Income Tax Amendment Act (No 2) 1993) it becomes an interest of the person in a FIF, then
with effect from that income year the attributed foreign net loss shall be treated as a FIF net loss, except if
the person calculates the FIF income or loss under the branch equivalent method. This provision [s IQ 9] was
inserted when the control rules were relaxed for CFCs, such that a foreign company that may have been a
CFC, ceased to be a CFC.

Under s IQ 2(1B) if a person’s attributed CFC net loss relates to an income year for which s IQ 2B applies
to the person (for income years beginning on or after 1 July 2009) and is carried forward to the tax year, a
deduction is allowed for that year under the general rules [s IQ 2]. This section deals with losses arising under
the new CFC rules that apply generally from the 2010-2011 income year: that is losses on passive account.
Losses incurred in prior income years, that is up to and including the 2009-2010 year (assuming the general
application date for the new rules of the 2010-2011 income year) are dealt with under s IQ 2(1C) and the
rules in s IQ 2B, as discussed below.

If, under s IQ 2(1), a person is unable to offset any part of the maximum amount that s IQ 2(1) allows to be
offset, because there is insufficient net income, the excess shall be treated as if it were a net loss for the
income year and will cease to be part of the attributed CFC net loss available to the person for that year and
becomes a tax loss component under s IA 2(4).

**Example:**
A person derives the following income in the 2008-2009 income year:

<table>
<thead>
<tr>
<th>Income Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment income</td>
<td>$40,000</td>
</tr>
<tr>
<td>Partnership loss</td>
<td>($50,000)</td>
</tr>
<tr>
<td>Attributed CFC income</td>
<td>$10,000</td>
</tr>
<tr>
<td>Attributed CFC loss carried forward</td>
<td>($5,000)</td>
</tr>
</tbody>
</table>

The ($5,000) loss balance is carried forward as a non-ring-fenced loss as there is a surplus of attributed CFC income against
which it could have been offset against. If the person with the attributed CFC income is a company, this amount could be grouped
with other wholly-owned group companies and offset under s IQ 4.

**850.123 Transitional rules for the use of attributed CFC losses accumulated under the branch equivalent rules**

With the introduction of the new CFC rules from the 2010-2011 income year, transitional rules have been
introduced to deal with attributed CFC net losses and FIF net losses carried forward from the previous rules.

Transitional rules are required because the measure of attributable income against which those losses can be
offset is now passive income only, whereas under the previous rules the branch equivalent income was
calculated on both active and passive income types. The value of the accumulated historical losses has
therefore been restricted under the new rules. This is achieved through s IQ 2B.

Importantly, when dealing with historical losses and attributed CFC income under the rules applying from
the 2010-2011 year, s IQ 2(1C) sets out the amount of the historical losses that can be offset and the amount
of the historical net losses that are lost (as the two do not necessarily equal one another). Specifically,
s IQ 2(1C) provides that the amount available for reducing the person’s net income is equal to the equivalent
CFC loss under s IQ 2B, and the amount of that attributed CFC net loss that is not available to the person
after the tax year (that is, the amount of historical losses that can no longer be carried forward) is equal to
the converted branch equivalent (BE) loss under s IQ 2B. Thus, in these situations, both the person’s
equivalent CFC loss and the converted BE loss will need to be determined.
Section IQ 2B(1) provides that the amount of attributed CFC net loss or FIF net loss from a jurisdiction that a person has carried forward from the previous rules is the person’s available BE loss for that jurisdiction. Section IQ 2B(2) provides that each year, some or all of this available BE loss is converted into an equivalent CFC loss, which is effectively an ordinary attributed CFC net loss under the new rules [s IQ 2B(2)(b)]. The amount of available BE loss converted each year is the converted BE loss that is then not available to be carried forward.

The amount of losses converted each year (and the conversion formula), is determined under s IQ 2B(4) to (7). Separate calculations are required for each jurisdiction. The conversion depends on the relationship between a person’s jurisdictional attributed income and the person’s jurisdictional BE income. These terms are defined in s IQ 2B(9). Jurisdictional attributed income only includes income from CFCs that is attributed under the new rules, whereas jurisdictional BE income includes the full branch equivalent income from CFCs that would have been attributable under the old rules. Full branch equivalent FIF income is included under both terms.

At this stage of the process it may be very tempting to exercise the choice available under s IQ 2B(3) and choose to give the CIR notice that the available BE loss for a jurisdiction not be carried forward. However, if it is decided to utilise accumulated BE losses, s IQ 2B(4) deals with the typical scenario in which a person’s jurisdictional BE income is greater than jurisdictional attributed income. In that case, the converted BE loss is equal to the person’s jurisdictional BE income (or to the available BE loss if this is lower). The equivalent CFC loss is equal to the person’s jurisdictional attributed income (or the amount calculated under s IQ 2B(4)(b)(ii) if this is lower).

Example:
A company has jurisdictional attributed income of $80, jurisdictional BE income of $200 and available BE losses of $1,000. The amount that may be offset against the jurisdictional CFC income is the equivalent CFC loss, which under s IQ 2B(4)(b) is the lesser of $80 and the amount obtained under s IQ 2B(4)(b)(ii), which is $400. The amount of losses accumulated under the old CFC rules must be reduced by the person’s converted CFC loss, is the lesser of $200 and $1,000. Accordingly, the loss offset for the year is $80, and the losses to carry forward reduce to $800.

Section IQ 2B(5) deals with the less common situation when jurisdictional attributed income exceeds jurisdictional BE income (which could be the case if there was a loss on active income account for example). In this situation the equivalent CFC loss is equal to the converted BE loss. Sections IQ 2B(6) and (7) deal with interest holders who are members of wholly-owned groups that include other resident members. For a member of a wholly-owned group, the conversion of historical losses to an equivalent CFC loss is done by reference to the jurisdictional income ratio of the group [s IQ 2B(9)].

Example:
Using the facts from the example above, but assume the taxpayer is a company that is a member of a wholly-owned group. We also assume that the group’s jurisdiction income ratio is 2. Under the standard situation in s IQ 2B(6) the outcome is:
(a) Under s IQ 2B(6)(a), the company’s converted BE loss is the lesser of $1,000 and the greater of $200 and ($80 × 2) $160, which is $200.
(b) Under s IQ 2B(6)(b), the company’s equivalent CFC loss is the amount calculated by multiplying the group’s jurisdictional income ratio by the company’s converted BE loss. This is: ($200 × 2) = $400.

A person or a wholly-owned group may elect, under s IQ 2B(8), to fix the jurisdictional income ratio using the average ratios over a two-year period, provided they had jurisdictional BE income in each of those years. Section IQ 2B(10) allows a person or a wholly-owned group to use the net profit or loss from financial accounts as a proxy for the branch equivalent income or loss of a CFC for the purposes of calculating their jurisdictional BE income.

850.125 Group of companies attributed foreign net losses
If a company (company A) has an attributed CFC net loss for any income year, or has carried forward to any income year an attributed CFC net loss, and the loss may not be offset by company A in the income year, company A may make the net loss available to company B. The loss grouping rules apply to the attributed CFC net loss as if it were a net loss arising on the last day of the income year for which it was attributed —
this is also the situation with attributed CFC net losses [s IQ 1(2)]. Therefore, if a company suffers a breach of continuity during an income year that breach will not affect any attributed CFC net losses for that year. The maximum attributed CFC net loss that any other company (company B) may offset against its net income for that income year may not be greater than the amount that company B would require as attributed CFC net loss for the same income year to produce a reduction in company B’s net income for the tax year equal the total of:

(a) Any attributed CFC income of company B for that income year in respect of any CFC resident in the same country or territory as that in which company A was resident in the accounting period for which the attributed CFC net loss arose; and

(b) Any FIF income of the company B calculated under the branch equivalent method and derived in that income year for an interest in a FIF resident in the relevant country.

An amount of attributed foreign income of company B may only be taken into account to the extent that it is not taken into account elsewhere.

If the company A is unable to offset any part of the maximum amount of attributed foreign net loss for the income year against net income of the other company for the year because there is insufficient net income, the excess shall be treated as if it were a tax loss component of company B for the year and will cease to be part of the attributed foreign net loss available to the first company. The rationale for this is the same as discussed at 850.120 (ie the maximum amount of the permitted offset is not reached, and as such the loss is no longer ring fenced).

(1) CFC losses exceed economic loss

Section EX 20 contains rules that reduce a person’s attributed CFC loss to the economic loss, if any, incurred in relation to that CFC interest. This rule is directed at, for example, situations when a person may have a right to require another person to purchase their interest in a CFC at a price set before the CFC incurred losses (ie the person has no economic loss from ownership of their CFC interest), but through the operation of the CFC attribution rules is entitled to attribute that CFC loss.

Section EX 20 applies in two situations, when:

(a) The person has an attributed CFC loss and the person suffers no, or substantially no, corresponding economic loss, whether because of a put or call option (as discussed in the Example above), or any other reason; or

(b) The person has an attributed CFC loss, and the amount exceeds the economic loss of the person because of the nature of the things taken into account in calculating the person’s income interest (through s EX 9) or for any other reason.

850.130 Foreign investment fund rules

The foreign investment fund (FIF) rules first applied from 1 April 1988 to entities resident in a prescribed list of low tax jurisdictions, and from 1 April 1989 to all entities not resident in grey-list countries. While the rules have been a feature of our tax landscape for over 20 years, the grey-list exemption has been effective in reducing the exposure of the FIF rules. However, from the 2007-2008 tax year generally, the FIF rules were substantially changed. The changes introduced new FIF income calculation methods for investment by a New Zealand resident in a FIF when the investor has a less than 10 per cent interest, referred to as a portfolio interest.

With the introduction of these changes, the FIF rules now apply differently to portfolio (less than 10 per cent) investment and non-portfolio investment. The new rules introduce new FIF income calculation methods for investment by a New Zealand resident in a foreign company when the investor owns less than 10 per cent of the company. Under the new rules for portfolio interests, the grey-list of countries is removed, and the fair dividend rate (FDR) income calculation method will be the default method for calculating FIF income. Generally, the FDR method taxes portfolio investment in foreign shares at five per cent of market value.

A number of exemptions have also been introduced. Investments in certain Australian-resident listed companies will be taxed as if they were New Zealand investments. The NZ$50,000 cost threshold continues
to apply (as it did before) for investments in offshore companies outside Australia, below which all investments continue to be taxable under general income tax rules.

For interests of less than 10 per cent the new FDR method will be the principle calculation method, with a cost method available when market value is unavailable. For interests of 10 per cent or more, the FIF rules apply essentially as they did prior to 1 April 2007.

(1) Application dates of portfolio FIF rules

For the majority of taxpayers (standard and late balance date taxpayers), the new rules apply from the 2007-2008 income year (ie 1 April 2007 for standard balance taxpayers or 1 July 2007 for a late balance date taxpayer with a 30 June balance date). However, for early balance date taxpayers the new tax rules apply from the start of their 2008-2009 income year (eg for a taxpayer with a 31 December balance date, the new rules apply from the start of their 2008-2009 income year on 1 January 2008).

A special application date rule applied for companies, group investment funds, or superannuation funds that intend to be portfolio investment entities. These entities were able to elect to defer the application of the new rules until 1 October 2007. For an election to defer the application date of the new rules, the taxpayer had to give a written notice to the CIR before 1 April 2007 (if the entity exists before that date) or within 1 month of the day on which the entity comes into existence (if the entity comes into existence between 1 April 2007 and 1 October 2007). This special application date rule for prospective portfolio investment entities is intended to align the start dates of the new offshore tax rules and the new tax rules for portfolio investment entities.

850.135 Definition of an interest in a FIF [ss EX 28, EX 29 and EX 30]

Deciding if something is an attributing interest in a FIF is a two-step process: first understanding what entities constitute FIFs, and second whether the interest held in that entity constitutes an interest in a FIF. The second step also requires an examination of the exclusions, which are listed in ss CQ 5 [see 850.140] and s DN 6.

A foreign investment fund (FIF), is a collective term used to describe any one of the following:

(a) A foreign company (which includes a unit trust);
(b) A foreign superannuation scheme;
(c) An insurer under a life insurance policy, but only if the policy is offered or entered into outside New Zealand; or
(d) An entity described in sch 25, Part A (of which no entity has ever been listed).

The following three categories of interests held by a person in a foreign entity (company, superannuation scheme or life insurance policy) are treated as an “attributing interest” in a FIF [s EX 29], unless an exemption applies:

(a) **Category 1**: A direct income interest in a foreign company, or in an entity described in sch 25, Part A;
(b) **Category 2**: Rights to benefit from a foreign superannuation scheme, as a beneficiary or member; or
(c) **Category 3**: Rights to benefit from a life insurance policy in relation to which the FIF is the insurer.

Categories 2 and 3 include rights that are contingent or discretionary, [s EX 29(5)]. That is, it includes rights to benefit from a superannuation scheme that are not only vested, but are contingent or discretionary. For example, a right or interest (in a superannuation fund) that does not vest until a certain date, or other event, but accrues income in the interim.

Section EX 30 sets out the rules that determine a person’s direct income interest in a foreign company. These rules are based on those used in determining a direct income interest for the purposes of the CFC rules [s EX 9, see 850.40]. For the purposes of the rules the term “company” includes an entity listed in sch 25, Part A. A company also includes a unit trust by definition.

A direct income interest in a foreign company is defined in s EX 30(1) as:

(a) Any shares in the foreign company;
(b) Any shareholder decision-making rights for the company [see 170.20];

(c) A right to receive or to apply any of the income of the company for the relevant accounting period;

or

(d) A right to receive or to apply any of the value of the net assets of the company if they are distributed.

The interest in the FIF is measured based on the rules used for measuring direct income interests in CFCs.

If a person becomes a resident or ceases to be a resident, the person’s interest is subject to the rules in ss EX 64. Under s EX 64 the person is treated generally as having acquired or disposed on the interest at market value depending on the circumstances. If the person is using the accounting profits or branch equivalent methods, the rules in ss EX 16 and EX 17 may adjust the size of the interest used to attribute the FIF income in these circumstances as a means of apportioning the FIF income subject to tax [see 850.225].

Note: Generally, an option to acquire an interest in a FIF is not recognised as a direct income interest. Only interests in the FIF that have an entitlement to income or assets or an ability to control an entitlement to income or assets are actually used in determining category 1 FIF interests.

850.140 When FIF income arises [ss CQ 4, CQ 5 and EX 45]

Section CQ 4 states that FIF income of a person is income.

Section CQ 5 sets out the circumstances when FIF income arises. This is identical to the circumstances when a person has a FIF loss as set out in s DN 6, and while the application of the FIF loss rules are discussed at 850.255, the discussion below on when FIF income arises applies equally to ss CQ 5 and DN 6, in relation to when FIF losses arise.

A person has FIF income if the person is a New Zealand resident (not being a transitional resident) and has rights in a foreign company, foreign superannuation scheme, rights under a life insurance policy issued by a non-resident, or rights in an entity listed in sch 25, Part A (which lists entities treated as a FIF — but to date no entity has been listed); and the rights are an attributing interest (direct income interest) in a FIF under s EX 29.

Given the broad definition of an interest in a FIF, deciding if FIF income arises is in large part determined by whether one of the exemptions applies. Thus, provided one of the exemptions listed below does not apply, and, in the case of natural persons (and a very limited number of trustees — not being trustees of a family trust), the FIF interest cost more than $50,000 [see 850.150], FIF income will arise.

FIF income does not arise if, at the time, the rights exempt from being an attributing interest under any of the following 15 exemption rules in s CQ(1)(c) [see 850.145].

In summary the exemptions are:

(a) The exemption for ASX-listed companies [s EX 31];

(b) The exemption for Australian unit trusts that turn over 25 per cent of profitable assets or distribute 70 per cent of their income [s EX 32];

(c) The Australian regulated superannuation savings exemption, for superannuation savings that are locked in [s EX 33];

(d) The CFC rules exemption [s EX 34];

(e) The exemption for 10 per cent or greater interest in a grey-list company exemption [s EX 35];

(f) The 10-year exemption for venture capital companies emigrating to a grey-list country [s EX 36];

(g) The 10-year exemption for a grey-list company that owns a New Zealand venture capital company [s EX 37];

(h) The exemption for shares in a grey-list company acquired under a venture capital agreement [s EX 37B];

(i) The exemption for an employee share purchase scheme of a grey-list company [s EX 38];

(j) The temporary exemption for interests in defined grey-list companies with a substantial number of shareholders resident in New Zealand [s EX 39];
(k) The temporary exemption for a grey-list company investing in Australasian Equities [s EZ 32];
(l) The foreign exchange control exemption [s EX 40];
(m) The exemption for a non-resident or transitional resident [s EX 41];
(n) The new resident’s accrued superannuation entitlement exemption [s EX 42]; and
(o) The non-resident’s annuity or pension exemption [s EX 43].

Section CQ 5(1)(d) excludes natural persons with FIF interests that cost $50,000 or less from the requirements to attribute FIF income [see 850.150]. Trustees of certain trusts (not family trusts) also qualify for the $50,000 cost threshold [s CQ 5(1)(e), see 850.150]. The $50,000 de minimis rule is not affected by the rules in ss EX 63, EX 65 and EX 67 that deem disposals and acquisitions at market value when, for example, a FIF exemption ceases to apply or a person changes a FIF calculation method. The $50,000 de minimis rule is affected when a person migrates to or from New Zealand [s EX 64, see 850.225].

Life insurance death benefits arising from insurance contracts entered into before 2 July 1992 are also excluded from FIF income under s EX 45, in either of the two following situations:
(a) The person (or deceased) entered into the policy that gave rise to the benefit when the person was not a New Zealand resident, and at that time had not been a New Zealand resident for at least the previous 10 years, and the benefit was not voluntarily increased after the person became a New Zealand resident; or
(b) The life insurance policy was taken out prior to 2 July 1992 and the benefit was not voluntarily increased on or after that date.

(1) Controlled foreign company with FIF interest
When a person has an income interest of 10 per cent or more in a CFC, a person can also have FIF income in an income year if the CFC holds an attributing FIF interest. This applies because FIF income of a CFC is attributed directly back to the persons with income interests of 10 per cent or more in a CFC under the rules for the calculation of branch equivalent income in ss EX 21(33) and EX 58 [see 850.210].

(2) FIF income of persons ceasing to be New Zealand resident
FIF income of a person who ceases to be resident in New Zealand is treated as being derived while the person was a New Zealand resident. This avoids the argument that the income is derived evenly over the income year [s EX 16(3)].

(3) Schedule 25
Schedule 25 contains three parts:
(a) Part A: that lists entities to be treated as FIFs;
(b) Part B: that lists entities that are excluded from the grey-list; and
(c) Part C: that lists entities that do not qualify for the accounting profits method.

The purpose of sch 25 was to provide flexibility to the FIF rules to deal with unforeseen eventualities. To date sch 25 has not been used.

850.145 When an interest in a FIF is not an attributing FIF interest
[ss CW 29, EX 31, EX 32, EX 33, EX 34, EX 35, EX 36, EX 37, EX 37B, EX 38, EX 39, EX 40, EX 41, EX 42, EX 43, EZ 32]

The concept of an interest in a FIF is very broad. In considering whether an interest is an attributing interest or not, regard must be had to the exemptions. These are discussed below. Regard must also be had to the investment threshold rule in ss CQ 5 and DN 6 [see 850.150]. An interest in a FIF is not an attributing FIF interest when one of the following exemptions applies.
**Australian-resident listed company exemption [s EX 31]**

Interests in shares in Australian resident companies listed on an approved index on the Australian Stock Exchange (that are not stapled stock shares per s EX 31(1)(b)) will continue to be taxed under general income tax rules — this means they will be taxed on dividends only if the shares are held on capital account, and on dividends and realised share gains if held on revenue account.

The key requirements are that:

(a) The person’s FIF interest is shares;
(b) The shares are not stapled stock;
(c) The company is resident in Australia at all times in the year when the person owns shares in the company;
(d) The shares are listed on an approved index at the beginning of the person’s income year or when the person first acquires the shares;
(e) The company is not listed in sch 25, Part B; and
(f) The company is required to maintain a franking account.

The Australian company must be resident in Australia at all times in the year. However, to meet the test, it is only necessary that that test is met during that part of the year when the New Zealand resident owned the shares: s EX 31(2)(a). Thus, if an Australian resident company migrated to another country and ceased being an Australian resident after a New Zealand person disposed of their rights in that company, then the exemption will still be met for that person in respect of that interest.

The exemption does not apply to an investment in an Australian resident company when, under an Australian double tax agreement, residence for treaty purposes is assigned to a country other than Australia. If residence for treaty purposes was a country other than Australia, the integrity of the Australian exemption would be compromised as the company may not be subject to full Australian tax. Like the general test of Australian residence, the test must be met at all times in the year when the person holds a right in the company. That is, if an Australian resident company was treated as a resident of another country after a New Zealand person disposed of their rights in that company, then the exemption will still be met for that person in respect of that interest as it was an Australian resident for the purposes of a DTA when the New Zealand resident owned the shares.

In considering the Australian ASX listing, it is necessary to be aware that the exemption for Australian resident companies is restricted to companies listed on an “approved” index of the Australian Stock Exchange (ASX). The approved ASX indices include the ASX All Ordinaries (the 500 largest listed companies), ASX 200 index, and ASX 50 Leaders. Answering this question may not be straightforward as companies do move on and off these lists. Inland Revenue now has a list (IR 871) on its website of the companies that are considered to meet the exemption. The website address www2.standardandpoors.com may also assist. Advice may need to be sought from a broker or financial adviser to check that the company was listed at the appropriate times.

The listing timing rules in s EX 31(2) are:

(a) Unless the taxpayer acquires the shares during an income year, the shares must be listed on the approved index at the beginning of the income year (being the New Zealand income year).

(b) For taxpayers who acquire the shares during the income year, then providing the taxpayer does not already own shares in that company, the shares must be listed on the approved index at the time of acquisition.

(c) The shares must be listed on an approved index at the beginning of the final month of the preceding income year if, in the first month of an income year, the shares are cancelled or are transferred under a scheme of arrangement entered into under Part 5.1 of the Corporations Act 2001 (Aust). This paragraph deals with situations when a company would have been listed on an approved index at the start of an income year, but has been removed as part of a Court-approved reorganisation. The effect is to allow shares that were listed at the start of the final month of a person’s income year, to be
regarded as listed at the start of a person’s income year when the shares were cancelled in the first month of an income year under a Court-approved arrangement.

**Example:**
Mark acquires shares in Australian Listed Company on 31 July 2008. Australian Listed Company is listed on the ASX All Ordinaries, and has been for many years. Mark is entitled to the Australian-resident listed company exemption as the company was listed on an approved index at the date of acquisition. The interest is thus not an interest in a FIF. However, if Australian Listed Company was not listed until subsequently, then the interest would be a FIF interest, until such time as it was listed on an approved index at the start of Mark’s income year next succeeding the date of listing.

The exemption does not apply if in the year when the person holds rights in the company, it is an entity described in sch 25, Part B.

Finally, the exemption only applies to interests in Australian resident companies that are required to have a franking account in accordance with Australian tax law. Generally, a New Zealand investor that receives a “franked” dividend from a company that is listed on the ASX All Ordinaries index will be entitled to this exemption. Similarly, if the dividend is not franked, this should alert the recipient to the fact that the exemption may not apply and further checks should be made.

Generally, interests in Australian unit trusts will not qualify for the Australian exemption because they are not required to have a franking account and are therefore subject to the new foreign investment fund rules. A limited exception for interests in certain Australian unit trusts is permitted by s EX 32. The exemption will not apply to any shares of an Australian company that are stapled to another security (being rights in another company), such that the securities can only be disposed of together.

**Note:** Investments in Australian-resident listed companies by portfolio investment entities will be taxable only on dividends, subject to the portfolio investment entity having full equity risk in the Australian share. This is because any realised share gains are treated as excluded income under s CX 55.

(2) **Australian resident unit trusts with adequate turnover or distributions [s EX 32]**

The tax treatment of Australian unit trusts, that are widely-held investment vehicles, differs from New Zealand unit trusts in that if the trust fully distributes its earnings the income is not taxed in the hands of the trustees, but rather in hands of the investors: on a flow through basis. Thus, if the trust invests in companies that pay no dividends, there may not be income to distribute. New Zealand investors in such trusts could, in theory, avoid the FIF rules by accumulating earnings growth in the unit value of the Australian unit trust, which could then be realised by selling units and avoiding a tax liability in both Australia and New Zealand — which was the very arrangement that the FIF rules were designed to target: although admittedly originally targeted at trusts in low tax jurisdictions.

For this reason Australian unit trusts were not regarded as eligible for the exemption from the FIF rules under s EX 31, which is restricted to investment in Australian resident companies listed on approved ASX indexes. However, investments in certain Australian resident unit trusts may be exempt if one of two conditions is met. The first (the turnover exemption) is that the unit trust turns over a minimum of 25 per cent of its profit-making assets (shares) each year. The second (the distribution exemption) is that the unit trust makes total distributions equal to or exceeding 70 per cent of the trust’s earnings for the trust’s year. In this regard, the reference to the trust’s year, is a reference to the accounting year of the trust that falls into the investor’s income year [s EX 32(1)(g)].

Both the turnover and the distribution exemption requirements ensures profit distributions (which are taxed as dividends in New Zealand) are made to New Zealand resident unit holders, and thus overcomes the concern with Australian unit trusts that essentially act as roll-up funds.

As with the Australian resident listed company exemption, the unit trust must be resident in Australia at all times in the year when the New Zealand resident holds a right in the trust. Also, at all times in the year when the New Zealand resident holds an interest in the unit trust, the unit trust cannot be treated as a resident of another country under a double taxation agreement that Australia has with that country.
The exemption does not apply, if the in the year when the person holds rights in the company, it is an entity described in sch 25, Part B.

In both cases, to qualify for the exemption, there must be an RWT proxy [TAA, s 15T, see 1260.15] in place when a distribution from the trust is made. With the exemptions linked to the RWT proxy requirement this gives assurance that New Zealand tax liabilities will be satisfied. It is also likely that the RWT proxy, who will generally be a New Zealand-based agent, should be in a position to advise investors on whether the Australian unit trust meets the exemption criteria. Nevertheless, it would be expected that an Australian unit trust offering investment in New Zealand would make it clear (perhaps in its offer documents) whether or not the unit trust qualifies for the exemption. This latter point is important as it would be very difficult for investors to be able self assess whether an Australian unit trust met this exemption.

(3) Turnover test [s EX 32(2) to (6)]

Investments in an Australian unit trust that meets the minimum turnover requirement and use the RWT proxy rules are exempt from the FIF rules. Importantly, this turnover requirement only applies to the shares held by the unit trust. That is, this exemption is not limited to Australian unit trusts that only have assets that are shares, rather the exemption is only applied to the assets of the trust that are shares.

The turnover exemption is also further restricted to those shares in profit. Share investments of the unit trust that are in loss will not count toward the turnover requirement. This is a deliberate policy design to ensure there is not an incentive to dispose of only loss making investments to meet the minimum turnover requirement. Thus, only investment in shares in profit is taken into account in determining whether 25 per cent of the total share investments of the unit trust are disposed of each year.

The 25 per cent minimum turnover test compares the realised gains of the Australian unit trust (for the trust’s accounting year that ends in the investor’s income year) with the unrealised gains of the “total profitable shares” held by the trust at the end of the trust’s accounting year. The realised gains must exceed 25 per cent of the net unrealised gains.

The realised gains are calculated in s EX 32(3) by the formula:

\[
\text{total disposal gain} - \text{total cost}
\]

Where:

“Total disposal gain” is the total amounts derived from disposal of the shares by the unit trust during the trust’s year; and

“Total cost” is the total cost of those shares to the unit trust.

This figure must exceed 25 per cent of the total net unrealised gains, calculated in the formula in s EX 32(5):

\[
\text{total profitable shares} - \text{total cost}
\]

Where:

“Total profitable shares” is the total of the market values of shares of the unit trust that are held at the end of the income year that have a market value greater than or equal to their cost to the unit trust; and

“Total cost” is the total cost of those shares to the unit trust.

For the purposes of the calculating the minimum turnover amounts, the turnover requirement relates to the unit trust’s accounting year that falls within the investor’s income year and the amounts are calculated in the currency in which the unit trust prepares its accounts. Inland Revenue advises that it has no problem with shares being sold and immediately repurchased for the purpose of satisfying the turnover requirement. This practice is sometimes referred to as “bed and breakfasting” [see TIB vol 19:3 (April 2007) at 33].

(4) Distribution exemption [s EX 32(7) to (9)]

Alternatively, the distribution exception could be applied to determine if the Australian unit trust is exempt from the FIF rules. The distribution exception applies when, during the trust’s year, the unit trust distributes 70 per cent or more of the total distributable gains calculated under the following formula:

\[
\text{closing equity + distributions} - \text{opening equity} - \text{contributions}
\]
Where:

“Closing equity” is the amount by which at the end of the trust’s year, the market value of the unit trust’s assets is more than the market value of the unit trust’s liabilities;

“Distributions” is the total amount of distributions to investors by the unit trust during the trust’s year;

“Opening equity” is the amount by which at the beginning of the trust’s year, the market value of the unit trust’s assets is more than the market value of the unit trust’s liabilities;

“Contributions” is the total amount of contributions by investors during the trust’s year.

Effectively, the exemption requires that the Australian unit trust distribute an amount during its year that equals or exceeds 70 per cent of the trust’s earnings for the year, calculated by reference to the market values of the trust’s assets.

Example:

Assume an Australian unit trust has an opening value of $5,000,000, and during the year receives contributions of $1,000,000, has a closing value on 30 June 2009 of $6,000,000 and derived $1,500,000 in gains on the disposal of equities.

$6,000,000 + $1,500,000 – $5,000,000 – $1,000,000 = $1,500,000

The trust would meet the distribution exemption in a New Zealand investor’s year to 31 March 2010 because it has distributed in excess of $1,050,000 (70 per cent of $1,500,000) during its year. In reality many widely-held Australian unit trusts should meet this exemption as they flow 100 per cent of their earnings to their investors. However, the unit trust will have to have an RWT proxy in place to qualify. This will limit the number of Australian unit trusts that will qualify.

(5) Exemption for Australian regulated superannuation saving [ss EX 33 and CW 29]

A person’s rights in FIF are not an attributing FIF interests if the person is a natural person and the right is an interest in a foreign superannuation scheme that is:

(a) An Australian approved deposit fund;
(b) An Australian exempt public sector superannuation scheme;
(c) An Australian regulated superannuation fund; or
(d) An Australian retirement savings account.

This exemption was introduced in the Taxation (Savings Investment and Miscellaneous Provisions) Act 2006 to recognise the problems people with interests in these schemes may face when they are resident in New Zealand, and is backdated to the commencement of the FIF rules (see application date below). The issue stems from the fact that individuals working in employment in Australia have compulsory contributions paid into a superannuation scheme made on their behalf by their employer. In general, Australian and New Zealand citizens cannot access these superannuation interests until they reach retirement age.

If these individuals migrate or return to New Zealand they could be subject to tax on these interests under the FIF rules if they continue to make contributions to the scheme after being resident in New Zealand for five years. If no further contribution is made the FIF interest will be exempt as an interest in an employment-related foreign superannuation scheme for New Zealand tax purposes [see discussion below on ss EX 41 and EX 42].

Anecdotally it was thought that individuals with Australian superannuation interests may not be complying correctly with their tax obligations under the FIF rules. In addition, the potential tax consequences under the FIF rules were thought to be a disincentive for individuals with interests in particular superannuation schemes to take up long-term or permanent employment in New Zealand.

Even though the FIF regime could be avoided by ceasing to make contributions to the scheme, members of defined benefit schemes must continue to contribute to preserve the expected value of their future entitlements. If they cease making contributions, the ultimate benefit payout could be significantly reduced from the level expected had contributions continued. If a member transferred his or her entitlements in a defined benefit scheme to another scheme, such as a defined contribution scheme, this transfer could also give rise to a tax liability under the FIF rules or general tax rules.
Section CW 29 provides roll-over relief in situations when an individual has withdrawn an amount from one of the listed superannuation schemes and reinvests the entire amount in another listed scheme. The amount withdrawn and reinvested will be exempt from income tax. This provision is necessary as, exemption from the FIF rules, does not equate to a total exemption from tax.

The scope of the new exemption will have wide coverage because most superannuation schemes in Australia (including schemes that receive compulsory employment superannuation contributions under Australia’s guarantee scheme) will fall within one of the schemes listed in s EX 33. These schemes are all subject to strict prudential standards and rules relating to the preservation and early release of superannuation benefits. A brief discussion on the schemes covered by the exemption is below.

In exempting these schemes from the FIF rules, the exemption should achieve the twin objectives of addressing trans-Tasman migration and compliance and tax costs arising under the FIF rules. Recall though that exemption from the FIF rules does not always exclude benefits paid from the scheme from New Zealand income tax — that is, it should not be assumed that an exemption from the FIF rules is an exemption for all purposes.


(6) Description of the Australian schemes

The schemes covered by the s EX 33 exemption are subject to strict preservation rules whereby benefits are generally locked-in until a person reaches retirement age. Individual schemes may have some capacity to pay benefits to people experiencing financial hardship and on compassionate grounds, but these payments are strictly limited. For example, payments may be made to treat life-threatening illnesses, to prevent foreclosure by a mortgagee or the exercise of an express or statutory power of sale over the family home. When a person dies the scheme will pay benefits in cash to the person’s dependents or the person’s estate. It is also possible to transfer benefits between superannuation schemes, but only to Australian schemes that meet certain regulatory standards, including the preservation of benefits.

The principal legislation governing the regulation of superannuation in Australia is the Superannuation Industry (Supervision) Act 1993 (SISA) and the Superannuation Industry (Supervision) Regulations 1994 (SISR).

(7) Approved deposit funds

Approved deposit funds were introduced in 1984 as an “approved” fund for receipt of superannuation lump sum payments. They were created as roll-over vehicles into which a member could transfer superannuation benefits so as to retain them in the superannuation system. ADFs thus receive hold and invest certain types of roll-over funds until the funds are withdrawn in accordance with the preservation rules in SISA. Due to subsequent legislative changes, superannuation funds can accept lump sum or roll-overs so ADFs have become less relevant.

(8) Exempt public sector superannuation schemes

Exempt public sector superannuation schemes provide for payments of superannuation, retirement or death benefits, and are established under:

(a) A Commonwealth, state or territory law; or

(b) The authority of the Commonwealth, state or territory government, or a municipal corporation, another local governing body or a public authority that is constituted by or under a Commonwealth, state or territory law.

These schemes are specifically listed in sch 1AA of SISR. Although these schemes are not regulated under SISA they conform to the principles of that Act.
(9) Regulated superannuation funds

These funds have made an irrevocable election for the regulatory provisions of SISA to apply to them. Most entities involved in the provision of superannuation in Australia will be regulated superannuation funds. They include:

(a) Corporate or employer funds, which are established and run by an employer (usually large) for its own employees;
(b) Industry funds, which are for employees of different employers in the same industry, for example — hospitality industry or building industry;
(c) Retail or public offer funds, which are open to anyone to join, and are usually run by large banks or life insurance companies; and
(d) Small funds approved by the Australian Prudential Regulation Authority and self-managed superannuation funds. These funds have five or fewer members and are predominantly used by the self-employed.

(10) Retirement savings accounts

These accounts are typically offered by banks or similar financial institutions and operate in a similar way to a bank account — accumulating small amounts deposited regularly by their members and by the member’s employer and paying interest on those deposits. The money is invested in assets that are low risk. The Retirement Savings Accounts Regulations 1997 contain preservation rules including restrictions on the early release of benefits from retirement savings accounts, which are identical to the preservation rules in the SISR.

(11) Preservation rules and restrictions on early release

Generally, superannuation benefits may be paid out only on the occurrence of one of the following events:

(a) Retirement on or after reaching preservation age. A person’s preservation age depends on his or her date of birth — if a person’s date of birth is before 1 July 1960, his or her preservation age would be 55 years. In addition, if a member is under 60 years of age the scheme must be satisfied that the member never intends to work again;
(b) Reaching age 65 years;
(c) Permanent incapacity;
(d) Termination, at any age, of gainful employment with an employer who had contributed to the scheme, as long as the benefits are paid in the form of a non-commutable lifetime pension.

The early release of superannuation benefits is not permitted on any grounds other than those specified by the relevant legislation. The final decision on whether a release is permitted on any grounds rests with the trustees of the applicant’s superannuation schemes, subject to the governing rules of the scheme.

There are two principal ways by which an individual can access his or her superannuation benefits before reaching retirement age. An individual can apply to his or her superannuation scheme’s trustee on the grounds of severe financial hardship; or alternatively, apply to the Australian Prudential Regulation Authority for release on compassionate grounds.

Benefits may be released on compassionate grounds in very limited circumstances. These circumstances are defined in relevant legislation or in the trust deed of the scheme and cover expenses for medical treatment, medical transport, modifications to the family home or motor vehicle because of severe disability, palliative care, and funeral expenses. Funds may also be released on compassionate grounds to prevent foreclosure of a mortgage or exercise of a power of sale over the member’s principal place of residence. Benefits can also be released to meet expenses in other cases where the release is consistent with one of these grounds.

The regulatory arrangements attempt to balance the need for superannuation benefits to be protected for retirement purposes against the need for access when superannuation fund members experience a personal emergency.
Non-preserved or unrestricted interests

The exemption applies to interests in superannuation schemes that are subject to preservation arrangements. However, some interests that were acquired before certain dates might not be preserved or restricted. This is because over the years the rules relating to accessing Australian superannuation benefits have been gradually tightened to encourage or enforce the preservation of member interests, but the general practice has been to grandparent any interests that members have had at the time of each change. Even so, these unpreserved or unrestricted interests should still qualify for exemption from the FIF rules as long as the scheme is listed in the new exemption provision.

CFC rules exemption [s EX 34]

A person’s interest in a foreign company will not be an attributing interest in a FIF if the interest constitutes an income interest of 10 per cent or more in a controlled foreign company for the relevant accounting period [see 850.40].

Exemption for 10 per cent or greater interest in a grey-list company [s EX 35]

Non-portfolio direct FIF interests of 10 per cent or greater in grey-list companies continue to be exempt from the foreign investment fund rules. The grey-list countries are: Australia, Canada, Germany, Japan, Norway, Spain, United Kingdom, and United States.

The grey-list exemption only applies if:

(a) The investor’s interest is at least 10 per cent at all times during the income year. If the interest drops below 10 per cent it will be necessary to consider if the exemption still applies for that year. Under s EX 65, a person is deemed to have sold their interest at market value if they used the CV, DRR, FDR or cost methods. If FDR can be used, there will be no income attributable to this interest until the following income year;

(b) The FIF is a grey-list company;

(c) The person is not a portfolio investment entity, a superannuation scheme, a unit trust, a life insurer, or a group investment fund. This is because these entities are seen as surrogate portfolio investments for their investors, and as such not entitled to the grey-list exemption for non-portfolio interests; and

(d) The FIF is not an entity listed in sch 25, Part B (which lists entities to which the grey-list exemption does not apply).

Note: In determining if the FIF is a grey-list company under s EX 33(2) of the ITA 2004, the FIF had to be liable to income tax in the grey-list country. Liability to income tax could either be by reason of domicile, residence, incorporation, or having its place of management in the grey-list country. The FIF was also considered to be liable to income tax if it was organised under the laws of the grey-list country and income tax imposed on the persons who held income interests in the FIF. For this latter purpose, 80 per cent or more of the FIF’s income must arise in that grey-list country. This does not seem to have been incorporated into ITA 2007, but is presumably an error to which the transitional rules would apply.

Venture capital company exemptions [s EX 36, EX 37 and EX 37B]

The offshore portfolio rules contain two principal exemptions for interests held in venture capital companies that would otherwise be FIF interests.

The first is an exemption targeted at venture capital investment in New Zealand: specifically resident start-up companies that subsequently migrate residence offshore to a grey-list country, but retain a presence in New Zealand through a fixed establishment. In the absence of this exemption, New Zealand investors with portfolio interests in such companies would find themselves subject to the FIF rules. Recall, New Zealand investors with interests greater than 10 per cent would be entitled to the grey-list exemption in s EX 35. The exemption only applies for a 10-year period.

This exemption recognises the commercial reality that venture capital companies may need to migrate offshore to gain access to additional equity funding or other resources not available in New Zealand. Further, venture capital investments do not compete with investment via New Zealand managed funds and therefore...
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are not the target of the offshore portfolio rules. The exemption deals with interests directly in the venture capital company that migrated [s EX 36], and with interests in a grey-list company that controls a venture capital company [s EX 37], depending on the structure used.

The second venture capital exemption relates to New Zealand residents that co-invest in a FIF with the New Zealand Venture Investment Fund, and is contained in s EX 37B.

(16) Venture capital company emigrating to grey-list country: 10-year exemption

The criteria in s EX 36, for the venture capital exemption for shares held directly in the venture capital company, are:

(a) The rights are a direct income interest; and
(b) The FIF is a grey-list company; and
(c) The FIF is not an entity described in sch 25, Part B; and
(d) The person has held shares in the company at all times after a time when the company was resident in New Zealand and the shares were not listed on a recognised exchange; and
(e) The company became a grey-list company immediately after having, for 12 months or more:
   (i) Carried on business in New Zealand; and
   (ii) Had in New Zealand more than 50 per cent of its assets; and
   (iii) Had in New Zealand more than 50 per cent of its employees; and
(f) The year begins less than 10 years after the company became a grey-list company; and
(g) At all times in the year the company has a fixed establishment in New Zealand; and
(h) Through the fixed establishment:
   (i) The company incurs expenditure other than interest of at least $1 million, or if less than $1 million, at least 25 per cent of the total company expenditure (again ignoring interest) is incurred through the fixed establishment, or
   (ii) At all times in the year, at least 10 full-time equivalent employees or contractors are engaged by the fixed establishment, or if less than 10 FTE staff or contractors are engaged by the fixed establishment, at least 25 per cent of the total number of staff engaged by the company are engaged by the fixed establishment.

Section EX 36(d) could be a little confusing. The reference in s EX 36(d) to shares held in the company “at all times”, allows shares acquired both before and after the company migrated to be exempt from the FIF rules. It would also permit shares to be acquired after the company listed on a recognised exchange to benefit from the exemption. As originally enacted it was not certain what treatment applied when people who already held interests in the company acquired more shares after the company migrated or listed.

The “carried on business in New Zealand” test in s EX 36(e)(i) means that the company need not have been incorporated for more than 12 months prior to migration, only that it carried on business in New Zealand for more than 12 months.

The provisions of s EX 36(h) allow the exemption to apply if, through the fixed establishment, the company incurs at least 25 per cent of its expenditure in New Zealand (ignoring interest), or has 25 per cent of its employees in New Zealand. This criteria permits smaller start-up enterprises, that have trouble meeting the $1 million or 10 employee requirements, to satisfy the exemption.

The exemption applies for a 10-year period. The relevant year under consideration is the year begins less than 10 years after the company migrated. For example, if a company migrated on 18 May 2009, the last qualifying year for exemption would be the income year commencing 1 April 2019, being the year beginning less than 10 years after migration.

When the exemption expires, the shares will enter the FIF rules at market value at the end of the 10-year exemption period [s EX 65, see 850.250]. For example, if last qualifying year for exemption was the income year commencing 1 April 2019, the value of the shares on entry to the FIF rules would be the market value.
on 1 April 2020. The $50,000 de minimis rule is not affected by the deemed disposal and acquisition [ss CQ 5(1B) and DN 6(1B)].

(17) Grey-list company owning New Zealand venture capital company: 10-year exemption

The venture capital exemption also extends to shares acquired in a grey-list holding company that controls a New Zealand company that meets the criteria of s EX 36. This allows for the situation when, for example, a grey-list company has acquired the New Zealand venture capital company by issuing shares to the New Zealand resident shareholders of the New Zealand venture capital company in exchange for their shares in the New Zealand resident company.

The criteria as set out in s EX 37 are:

(a) The rights are a direct income interest;
(b) The FIF is a grey-list company;
(c) The FIF is not an entity described in sch 25, Part B;
(d) The person has held shares in the company at all times after a time when the shares were not listed on a recognised exchange; and
(e) At all times in the year, the company holds more than 50 per cent of the voting interests in a company resident in New Zealand (being the resident venture capital company) that, for 12 months or more has:
   (i) Carried on business in New Zealand; and
   (ii) Had in New Zealand more than 50 per cent of its assets; and
   (iii) Had in New Zealand more than 50 per cent of its employees; and
(f) The year begins less than 10 years after the grey-list company first owned more than 50 per cent of the voting interests in the resident company; and
(g) The resident company through a fixed establishment in New Zealand:
   (i) Incurs expenditure other than interest of at least $1 million, or if less than $1 million, at least 25 per cent of the total company expenditure (again ignoring interest) is incurred through the fixed establishment; or
   (ii) At all times in the year, at least 10 full-time equivalent employees or contractors are engaged by the fixed establishment, or if less than 10 FTE staff or contractors are engaged by the fixed establishment, at least 25 per cent of the total number of staff engaged by the company are engaged by the fixed establishment.

The criterion in s EX 37(d) is not immediately clear. As originally enacted this criterion stated that the person must have acquired the shares in the grey-list company when it was not listed on a recognised exchange. As with s EX 36, the question arose of the treatment of shares acquired after a listing. Section EX 37(d) allows shares acquired in the grey-list company after the company has listed on a recognised exchange to benefit from the exemption provided the person held shares in the grey-list company at all times after the time when the shares were not listed on a recognised exchange.

Similar to the provisions in s EX 36, the relevant income year must begin less than 10 years after the grey-list company first owned more than 50 per cent of the voting interests in the resident company. For example, if a grey-list company acquired all the shares of a New Zealand resident venture capital company on 18 May 2009, the last qualifying year for exemption would be the income year commencing 1 April 2019.

(18) Shares in grey-list company acquired under venture investment agreement

The second principal venture capital exemption is contained in s EX 37B. This exemption is for FIF interests held by New Zealand residents that co-invest in a FIF with the New Zealand Venture Investment Fund.

The criteria in s EX 37B provide that an interest in a FIF will not be an attributing interest if:

(a) The FIF is a grey-list company; and
(b) The person first acquires a share or option to buy a share in the company under a venture investment agreement, and the share or option was acquired at the same time and on the same terms as an acquisition of an interest in the FIF by the Venture Investment Fund or a company owned by the Venture Investment Fund.

The New Zealand Venture Investment Fund is a crown-owned company established to promote New Zealand’s venture capital industry. A related exemption for non-residents investing along side the New Zealand Venture Investment Fund is contained in s CW 13 [see 370.30]. That section also defines “venture investment agreement”.

(19) Employee share purchase scheme exemption [s EX 38]

There is a narrow exemption from the offshore portfolio rules for individuals who have shares in a grey-list company that was acquired through an employee share purchase scheme, and there are restrictions on the disposal of those shares.

The exemption applies when the following criteria are satisfied:

(a) The person is a natural person;
(b) The rights are a direct income interest;
(c) The FIF is a grey-list company;
(d) The FIF is not an entity described in sch 25, Part B;
(e) At the time the shares are acquired, the FIF is the employer of the employee or owns, directly or indirectly, the employer of the employee;
(f) The person acquires the shares under a share purchase agreement as defined in s CE 7 [see 340.30];
(g) The share purchase agreement includes a restriction on the disposal of the shares that affects for the income year the value of the benefit to the person under the agreement; and
(h) At the beginning of the year the period of restriction has not expired, or has expired for a period of less than six months.

If all the above criteria are met, the FIF rules will apply from the beginning of the income year after the income year in which the period of restriction ends. If at that time the period of restriction has not expired for more than six months, then the FIF rules will apply from the beginning of the next income year. The six-month period may allow some people the opportunity to dispose of their shares if they wish to avoid the FIF rules.

It is not a requirement of these rules that the restriction on the disposal of the shares affects their value. If the interest was a non-portfolio share investment, the grey-list exemption in s EX 35 would apply.

(20) Terminating exemption for grey-list company with numerous New Zealand shareholders [ss EX 39, EZ 32]

Temporary exemptions from the FIF rules are provided for five years and two years respectively for interests held in certain defined investment companies resident in a grey-list country.

(21) Five-year exemption [s EX 39]

Under the five-year temporary exemption, investments in companies that meet the required criteria (outlined below) are excluded from the offshore portfolio rules for a period of five years (ie for the 2007-2008 to 2011-2012 income years). The exemption was designed to give companies with significant New Zealand shareholding the opportunity to reconsider relocating to New Zealand.

For this exemption to apply the grey-list company must give notice to the CIR that on 17 May 2006 the company satisfied the requisite criteria. The notice must be given by 17 January 2007. Using the exclusion to the secrecy rules in s 81(4)(mc) of the TAA, Inland Revenue has advised that Guinness Peat Group Plc has given notice that it meets the criteria in ss EX 39(1)(b) and (1)(c) [see TIB vol 19:3 (April 2007) at 34]. GPG is the only grey-list company that meets this exemption. Effectively this exemption is closed to any other company, even if it meets the core criteria.
The criteria are:
(a) The rights are a direct income interest;
(b) The FIF is a grey-list company;
(c) On 17 May 2006, the company
   (i) Was a grey-list company; and
   (ii) Was not an entity described in sch 25, Part B;
   (iii) Had more than 20,000 shareholders who have addresses in New Zealand on the company’s
        share register;
   (iv) The shareholders in (iii) hold shares in the company carrying voting interests of more than
        50 per cent; and
   (v) Had assets of which more than 50 per cent in total value are shares in other companies carrying
       voting interest of more than 50 per cent; and
(d) On 17 May 2006 there share were listed on a recognised exchange in New Zealand and on a recognised
    exchange in a grey-list country.

In terms of s EX 39(4) a person may elect not to apply the exemption. Once made the election applies to the
subsequent income years subject to the exemption. The election is made by completing a return of income
on the basis that the election does not apply. A person may choose not to apply the exemption if the tax
outcome is lesser under the FIF rules than ordinary rules, for example, if tax would arise on gains made on
the disposal of GPG shares held on revenue account.

(22) Two-year exemption [s EZ 32]
A temporary exemption of two years (ie for the 2007-2008 and 2008-2009 income years), from the offshore
portfolio rules is provided for interests in grey-list companies that invest primarily in Australasian equities.
The purpose of this temporary exemption is to allow relevant grey-list companies time to relocate to New
Zealand and become portfolio investment entities.

As with the five-year exemption in s EX 39, for this exemption to apply, the grey-list company must give
notice to the CIR (by 17 January 2007) that on 17 May 2006 the company satisfied the requisite criteria.

Using the exclusion to the secrecy rules in s 81(4)(mc) of the TAA, Inland Revenue has advised that the New
Zealand Investment Trust Plc has given notice that it meets the criteria in s EZ 32 (or what was s
EX 33B(2)(b) of the ITA 2004) [see TIB vol 19:3 (April 2007) at 34]. As this exemption is now closed the
NZIT Plc is the only FIF that potentially qualified. However, the NZIT was liquidated on 29th February
2008. New Zealand residents with an interest in NZIT will not be covered by an exemption specific to this
FIF, and unless another exemption applies FIF income will arise under the FDR rules for the 2008 income
year.

(23) Foreign exchange control exemption [s EX 40]
This exemption applies if and to the extent to which the person is a natural person and acquired the rights:
(a) Before first becoming a New Zealand resident; or
(b) Before exchange controls applying to the person and the interest were imposed by a foreign country; or
(c) Before 8 pm NZST on 2 July 1992; and
exchange controls prevent the person from deriving amounts from the rights, or from disposing of the rights,
in New Zealand currency or for a consideration that is readily convertible into New Zealand currency.
This exemption was designed to ensure that natural persons unable to realise the benefit from the disposal
of any FIF interests because of exchange control regulations were not subject to tax under the FIF rules.
(24) Exemption for income interest of non-resident or transitional resident [s EX 41]

An interest that is a category 2 or category 3 right, as defined in s EX 29(3) and (4), as interests in foreign superannuation and life insurance, are not an attributing FIF interest if:

(a) The person is a natural person;
(b) The person acquires the rights in the FIF when non-resident or transitional resident; and
(c) At the time the person is not resident in New Zealand or is a transitional resident.

Note: The four-year exemption for interests in foreign superannuation and life insurance (category 2 and 3 FIF interests) is now subsumed by the transitional resident’s exemption [see 370.35].

(25) New resident’s accrued superannuation entitlement exemption [s EX 42]

This exemption (previously known as the employment-related foreign superannuation scheme exemption) is designed to give relief from the FIF rules to people who migrate to New Zealand, and who are unable to dispose of an interest in a foreign superannuation scheme acquired through their employment or self employment.

The exemption targets people with interests that are locked into an employment-related superannuation scheme under the terms of the scheme, or if they are able to get out of the scheme, there is a substantial cost in doing so. The types of superannuation scheme [defined in ss EX 42(5)-(8)] that qualify for this exemption are discussed below. Without the exemption, people with interests in these types of superannuation schemes (that are not exempted anywhere else) are effectively locked into the FIF rules and taxed accordingly.

The exemption excludes contributions to a foreign superannuation scheme made during any period of non-residence and contributions made during a period of residence in New Zealand that begins on the date a person becomes resident and ends before the first day of the fifth income year following the income year in which the person became a New Zealand resident. The exemption applies any time a person becomes resident in New Zealand. There is no minimum or other qualifying length of non-residence.

The two limbs of the exemption are illustrated in the following diagram.

If the person stops contributing to their foreign superannuation fund at any time within the five-year period [s EX 42(2)(b)], then no FIF income will arise in respect of the market value of the FIF interests acquired during those periods. However, if a person continues to contribute to the foreign superannuation scheme after the first day of the fifth year following the year the person became resident in New Zealand then FIF income will arise in respect of the FIF interest attributable to those contributions.

A formula is employed in s EX 42(3) to determine the value of the interest that is excluded from the FIF rules, and hence also the value of the FIF interest that is an attributing FIF interest if contributions continue to be made after the end of the five-year period. The formula is:

\[ \text{closing value} - \text{opening value} \]

Where:

“Closing value” is the market value of the rights on the day that ends the period; and
“Opening value” is the market value of the rights on the day that begins the period.
A question that often arises is whether, if a person continues to contribute after the period of five years, does this mean that all of the interests or rights of the person in the s EX 42 foreign superannuation scheme become an interest in a FIF? Alternatively, is it just the FIF interests acquired after the end of the five-year period? The intention of the rules is to exclude interests acquired during the periods set out in s EX 42(2). Accordingly, the formula should be applied to exclude the market value of the interests acquired during the period when the person was not resident in New Zealand and prior to the end of the five-year period in s EX 42(2)(b). This is confirmed in TIB vol 18:5 (June 2006) at 121, where it is stated that “the result of the formula is the value of the rights are permanently exempt from the FIF rules”. This view is also consistent with the intention to enable the exemption to apply whenever a person becomes a New Zealand resident.

**Example:**
A previously non-resident person becomes a New Zealand resident on 1 October 2006. The person then departed New Zealand on 23 December 2011 and returned again on 18 May 2018. The person continued to contribute to their foreign superannuation scheme at all times. Interests acquired in the FIF up to 31 March 2011 will be excluded. FIF interests acquired on and after 1 April 2011 up to 23 December 2011 will constitute an attributing FIF interest. Upon resuming New Zealand residence, contributions to the superannuation scheme during the period of non-residence are excluded, as are any contributions made for the period to 31 March 2023. Contributions made after this date will constitute attributing FIF interests.

**Note:** Attributing FIF interests acquired between 1 April 2011 and 23 December 2011 will be an attributing FIF interest when the person commences New Zealand residence again on 18 May 2018. See s EX 64 for treatment when a person ceases and reacquires New Zealand residence. If FIF interests are excluded from the FIF rules, they may very well constitute an interest in a trust or unit trust depending on the nature of the interest. This has implications if an amount were distributed from the fund.

To qualify for the exemption under s EX 42, the superannuation scheme must have the following characteristics:

(a) The scheme is one when the person’s rights can only be acquired through employment, or the person must be wholly or mainly self-employed when the rights were first acquired or when applying the exemption provision;

(b) The amount contributed to the scheme by or for the person must be calculated by some fixed relationship to the person’s income from employment or self-employment, or to provide benefits that bear a fixed relationship (ignoring inflation) to the person’s income from employment or self-employment;

(c) Contributions to the scheme for the person’s benefit must be made only by or for the person, the person’s employer (or a person associated with the employer), or a transfer from another superannuation scheme that would have qualified under s EX 42;

(d) The person’s future benefit under the scheme must not be able to be assigned or exchanged for a current receipt of cash, except if:
   (i) The person becomes physically incapacitated;
   (ii) The benefits are transferred to a similar scheme;
   (iii) When or after the person retires at normal retiring age;
   (iv) If the person is assigning the benefit rights to a spouse [see 960.10] under a relationship agreement; or
   (v) At the cost of a substantial decrease in the present value of the benefits.

If the entitlement rights to a superannuation scheme are transferred under a relationship agreement, the exemption will only apply if the transferor spouse would have been entitled to the exemption. Accordingly, the rights must be acquired when the spouse was a non-resident or during the five-year period under s EX 42(2)(b) [s EX 42(9)]. If a transfer is made from one superannuation scheme into another scheme, the transferor fund must qualify for the exemption [s EX 42(7)(c)].
As originally introduced, this exemption applied for contributions made when non-resident and for four years following the date of becoming a New Zealand resident. It also only applied on the first occasion a person became a New Zealand resident. This changed when s EX 36 of the ITA 2004 [now s EX 42] was amended in the Taxation (Depreciation, Payment Date Alignment, FBT and Miscellaneous Provisions) Act 2006 to extend the period of the exemption to five years following the date of becoming a New Zealand resident and to allow the exemption to apply on any subsequent occasion a person acquired New Zealand resident status. The change was made retrospective to the commencement of the FIF rules, being the 1991-1992 income year, for taxpayers with non-standard accounting years ending after 2 July 1992, or the 1992-1993 and subsequent income years for other taxpayers. Applying the change retrospectively recognises the reality that many taxpayers may not have been aware that the exemption did not apply to returning residents, and thus many people may have been unaware of their FIF obligations. Section EX 33 may well now exempt interests in certain Australia superannuation funds (see discussion above).

For the purposes of the $50,000 de minimis rule in ss CQ 5(1)(d) and DN 6(1)(d), the FIF interests that are not attributing interests under s EX 42, are not taken into account when determining the $50,000 cost (ie the exempted interests are disregarded).

(26) Non-resident’s pension or annuity exemption [s EX 43]

A category 2 or 3 interest [as per s EX 29] that is a right to benefit from a pension or annuity is exempt from the FIF rules if the non-resident’s pension or annuity exemption in s EX 43 applies.

This will be the case if the consideration for the entitlement was provided to the foreign entity:

(a) When the person was not resident in New Zealand; or
(b) When the person was resident in New Zealand but before the end of the third income year following the income year in which the person last became resident; or
(c) When the person was resident in New Zealand if the interest was commuted or transferred in anticipation of or following the person ceasing to be a New Zealand resident; and
(d) The person’s future benefits arising from the entitlement are not able to be assigned, or exchanged for a current receipt of cash (or other property), except to a spouse [see 960.10] under a relationship property agreement, or at the cost of a substantial decrease in the present value of the benefits.

See the Appendix to TIB vol 8:5 (September 1996) and TIB vol 13:2 (February 2001) at 38-39, for further details and examples of what was then the qualifying foreign private annuity exemption from the FIF rules.

Rights held to which this exemption applied could remain subject to the FIF rules if the rights were acquired before the 1996-1997 income year, and the person chose to treat the rights as an interest in a FIF for the 1996-1997 and later income years, by complying with the requirements in s CG 15(4) of the ITA 1994. This was because the income calculated under the FIF rules may have been less than the amount of the taxable pension or annuity.

There is a close relationship with s EX 42. The rules in ss EX 43 were introduced to target people who were resident in New Zealand and in receipt of a foreign pension or annuity, or who became resident in New Zealand at or about the time of retirement and were likely to be in receipt of a pension or annuity shortly thereafter. The rules were designed to tax pensions and annuities on a cash receipts basis, and thus avoid the complexities of the FIF rules for superannuitants. Thus, provided the criteria in s EX 43 is met, a pension or annuity is taxed in New Zealand on a cash receipts basis, rather than under the FIF rules.

Section EX 43 was designed to give the same result, only more explicitly. However, there are subtle differences between the rules. The principal difference is that the s EX 43 exemption is not limited to...
superannuation schemes defined for the purposes of s EX 42. Also, the five-year rule in s EX 42 was extended to five years and the rule in s EX 43 (that is supposed to align) was overlooked.

An interesting technical issue is the nature of the income for tax purposes. If the foreign superannuation scheme meets the definition of a unit trust, the receipt may actually be a dividend.

27) $50,000 Investment threshold rule [ss CQ 5, DN 6]

Under s CQ 5, a natural person with aggregate attributing FIF interests, other than in that person’s capacity as a trustee, with a cost of $50,000 or less (at all times during the year) are not subject to the requirements of the FIF regime. This applies to all FIF interests, including interests in foreign life insurance policies and foreign superannuation schemes. FIF interests that are specifically exempted from the FIF rules (discussed above), are not taken into account in determining the $50,000 cost de minimis. The $50,000 investment threshold rule is discussed in more detail at 850.150.

850.150 Investment threshold rule [ss CQ 5, DN 6 and EX 68]

If the original cost of all FIF interests is $50,000 or less at all times in an income year, the FIF rules do not apply for that year.

In determining cost, there is a special rule available in ss EX 68(10) and (11) to assist investors who have no record of the cost of their investments. Especially if the investments have been held longer than seven years (ie longer than the statutory period for holding on to tax records) [TAA, s 22(d) see 1210.10]. The rule applies for FIF interests acquired prior to 1 January 2000, that are still held at 1 April 2007. The rule allows investors to use half the market value of their FIF interests as at 1 April 2007 as a surrogate for cost when measuring the $50,000 cost threshold. The half market value is added to the cost of taxpayers’ other foreign shares to determine if the threshold is met for the year concerned. Treating the cost of pre-2000 interests as half of the market value is optional, but once elected cannot be changed in subsequent income years. If this option is chosen it must be used for all investments acquired before 1 January 2000.

Once the $50,000 threshold is breached all shares held in foreign companies that are not otherwise exempted become subject to the FIF rules. If the threshold applies (ie cost is less than $50,000) the taxpayer will continue to pay tax on dividends. No other tax is payable, provided the interest is not held on revenue account.

This minimum threshold also encompasses interests in foreign superannuation schemes and life insurance policies. Expenditure incurred on a person’s behalf, as well as expenditure directly incurred by the person, is taken into account in determining whether the $50,000 threshold has been reached. Employer contributions to foreign superannuation schemes are also taken into account for this purpose.

If the cost of a person’s offshore interests exceeds $50,000, all their interests are subject to the FIF rules — not just the excess costing more than $50,000. If in an income year the threshold is exceeded, a person cannot sell down their interest to bring themselves back within the threshold for that year. This is due to the wording of ss CQ 5(1)(d) and DN 6(1)(d) that refers to the threshold being breached “at any time during the income year”. However, a person could sell-down and bring themselves under the cost threshold for the following year.

In measuring the $50,000 threshold regard must be had to the rules in s EX 68. Section EX 68 also applies in determining cost for the purposes of the CV, DRR, FDR and cost methods. Section EX 68 sets out rules that apply in cases of share splits or similar, non-monetary costs and holding costs. In terms of s EX 68(9) holding costs (ie interest), are excluded from the cost of a FIF interest. However, costs of acquisition (ie brokerage), are most likely included [see TIB vol 19:3 (April 2007) at 31].

Note: In excluding holding costs from “cost” for the purposes of the FIF rules, this does not mean that these costs are not deductible. The exclusion is designed to prevent these costs from being double counted (ie as both an addition to cost under the FIF rules and as a deduction under the general provisions).

The exchange rate on the date of purchase of any shares in foreign currency should be applied for the purposes of the $50,000 minimum threshold. Inland Revenue advise that they will accept information obtained from websites that contain on-line currency conversion calculators [see TIB vol 19:3 (April 2007) at 31]. The key issue when applying the exchange rates is to use the rate applicable at the correct time.
The cost of shares held through a partnership will have to be taken into account in proportion to the person’s partnership interest (ie each partner’s proportionate share of the cost will be the amount to be considered). A married, de facto, or civil union relationship may qualify for a $100,000 threshold in aggregate if they purchase shares jointly. Each spouse adds half the cost of the jointly-owned shares to the cost of their individual shares to determine if they come within or exceed the threshold. However, married, de facto, or civil union relationship people cannot use any unused threshold amount of the others.

Example:
If each de facto spouse owns shares in their own name costing $10,000 and jointly own shares with their de facto spouse costing $60,000, then both de facto spouses would qualify for the threshold and remain outside the FIF rules until such time as they purchased additional foreign interests. Each spouse’s $50,000 total is calculated by adding the shares they individually own ($10,000) and half ($30,000) the shares they jointly own. However, if one spouse individually owned shares costing $40,000, then that spouse’s cost would exceed the $50,000 cost threshold and that person would be subject to the FIF rules from the time the $50,000 cost threshold was exceeded. The spouse’s total cost would then be $70,000 ($40,000 plus $30,000 share of jointly owned shares). The other spouse would still qualify for the threshold as their total cost would be $40,000.

Family trusts (other than those limited suite of trusts referred to immediately below) do not get the benefit of the $50,000 minimum threshold.

The $50,000 minimum threshold for the application of the new offshore tax rules also applies to the following small range of compensation-type trusts [ss CQ 5(5)DN 6(4)]:
(a) The trust is of the estate of a deceased person and the income year begins on or before the day that is five years after the person’s death;
(b) The settlor of the trust is a relative or legal guardian of the beneficiary, or a person associated with a relative or legal guardian of the beneficiary, and is required by a court order to pay damages or compensation to the beneficiary;
(c) The settlor of the trust is the estate of a deceased person and a court order requires the proceeds of damages or compensation to be settled on the trust for the beneficiaries of the trust;
(d) The settlor is the Accident Compensation Corporation (ACC).

Importantly, interests in foreign companies, that are covered by the various exemptions from the FIF rules (eg investments in Australian-resident listed companies), [see 850.140] do not count towards the $50,000 threshold.

If a person who holds FIF interests costing less than $50,000 is deemed to have disposed of and reacquired their FIF interest at market value under the rules listed below, the person is not deemed to have disposed of the FIF interests and reacquired them at market value for the purposes of the $50,000 cost threshold rule [s CQ 5(1B)]. The rules that deem disposals and reacquisitions in certain circumstances are:
(a) The rules relating to change of FIF calculation methods in s EX 63;
(b) Changes in the application of the FIF exemptions in s EX 65 [see 850.250]; or
(c) The rules in s EX 67 that apply when the FIF rules first apply to an interest for an income year beginning on or after 1 April 2007 [see 850.290].

For a discussion on the cost of inherited shares see 850.260.

850.155 Calculation methods and limits on choice of calculation methods
[ss EX 44, EX 46, EX 47; TAA s 91AAO]

(1) Calculation methods available
With the introduction of new rules for the taxation of offshore portfolio investments, there are now six FIF calculation methods available under the FIF rules — the original four methods: branch equivalent (BE), accounting profits (AP), deemed rate of return (DRR), and comparative value (CV) — plus the new fair dividend rate (FDR) and cost methods.

The new FDR method is likely to become the primary method used for calculating FIF income for foreign portfolio interests. However, the CV method will also be used when the return on the overall portfolio for

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The other FIF income calculation methods: branch equivalent, accounting profits, comparative value, deemed rate of return and cost can all be used if the conditions of those methods are satisfied.

Subject to the rules on the choice of calculation methods in ss EX 46, EX 47, EX 48 and EX 62, a person chooses their calculation method by completing and furnishing their return of income accordingly [s EX 44(2)].

Note: The FDR method generally applies on a pooled basis and not an investment by investment basis.

For interests in foreign companies, the FDR method is only available for interests of less than 10 per cent: in fact most non-individuals with portfolio interests are stuck with FDR unless the FDR method is excluded because the interest is a non-ordinary share [ie a share equivalent to debt in terms of s EX 46(10)] or a determination prohibits its use. However, a portfolio investment entity (PIE), an entity eligible to be a PIE or a life insurance company may use the FDR method for interests greater than 10 per cent if the FIF is a foreign PIE equivalent (essentially a non-resident PIE that is either a superannuation fund or a company).

(2) When calculation methods may be used — limits on choice

Section EX 46 sets out the circumstances when a particular calculation method can be used. After the introduction of the FDR method, most taxpayers will be interested in when that method must be used and the times when another method can be used. This is discussed below.

Note: Section EX 46 is not a complete code on when a method may be used. Rather, it sets limits in relation to the types of FIF interests that are the subject matter of that provision. For example, while it imposes limits on the use of FDR in relation to foreign companies, it is silent on the use of the method in relation to foreign life insurance and superannuation: there is nothing preventing the use of FDR for those types of FIF interests.

As a general rule, once a FIF calculation method is chosen for an interest in a FIF, s EX 46(1) contains a consistency rule that requires a person to use the same FIF calculation method if the person has two or more attributing FIF interests in the same FIF for the same period. The consistency rule does not apply when the interests are of different classes, in which case different methods may be used for the different classes. The consistency rule also does not apply if s EX 46 prevents the use of the same method. Despite the consistency requirements, a person may elect to change a FIF calculation method if the rules in s EX 62 permit this [see 850.240].

Importantly for people with portfolio interests, the rules allow natural persons and family trusts to change between FDR and CV (despite the consistency requirements) to allow tax to be paid on a lower return if that is less than five per cent. This is discussed under the FDR method discussion below.

(3) Fair dividend rate (FDR) method

The FDR method may only be used for interests of less than 10 per cent in foreign companies [s EX 46(7)(a)].

There are three exceptions:

(a) The shares in foreign companies are non-ordinary shares treated as equivalent to debt under s EX 46(10) [see ss EX 46(6)(d) and EX 46(8)(a)];

(b) When a natural person or the trustees of a family trust choose to use the comparative value for another attributing FIF interest that is a share. In this case all FIF interests that would have otherwise qualified for FDR must use CV person [s EX 46(8)(b)]; and

(c) When the FIF is a foreign PIE equivalent and the person is a PIE, an entity that qualifies for PIE status (ie a superannuation fund that is eligible to elect to be a PIE) or a life insurance company. These entities can use the FDR method for any level of interest they hold when the FIF is a foreign PIE equivalent. Because of the widely held nature of these investing entities, investments by these entities can be regarded as being in substance, portfolio investments, and always entitled to use the FDR method [s EX 46(7)(b)].
If a person’s interest in a foreign company equals or exceeds the 10 per cent threshold during the year (that is, the interest increases from less than 10 per cent to 10 per cent or more), then eligibility to use the FDR method for that year depends on whether the FIF interest is a grey-list FIF or not. This comes from the rule in s EX 46(7)(a) that states that a person may use the FDR method if the person’s direct interest in the FIF (including those of associated persons) is less than 10 per cent at:

(a) Any time in the income year if the FIF is a grey-list company; or
(b) All times in the income year if the FIF is not a grey-list company.

Thus, if a person’s interest increases to 10 per cent or greater during a year, the rules allow taxpayers to use the FDR method for that year if the FIF is a grey-list FIF (note the grey-list exemption in s EX 35 requires the interest to exceed 10 per cent for the full year so would not apply during the year a FIF interest increases to 10 per cent or more or reduces to less than 10 per cent). Allowing the person to use FDR in the year they increase their interest to 10 per cent or more avoids the person having to use another FIF calculation method (most likely the CV method) for the year they breach the less than 10 per cent threshold.

People with interests in non-grey-list FIFs, and who increase the size of their interest to 10 per cent or more (or for that matter, reduce their interest below 10 per cent), will not be eligible to use the FDR method for that year. For these people, they will use a FIF method other than FDR for the year in which the interest increases to 10 per cent or more (or reduces below 10 per cent as the case may be).

If a person’s interest in a grey-list company decreases to an interest that is less than 10 per cent during an income year, there is no FIF income at all for that year under the FDR method. This is consistent with the principles underpinning the FDR rules that purchases of shares during the year are ignored (quick sales aside). In other words, the rules treat the fall to a less than 10 per cent holding analogous to an acquisition. Thus, for example, if a person has a 20 per cent holding at the start of the year and they reduce this to nine per cent during the year, they are treated as acquiring the nine per cent interest during the year. Thus, when a person’s interest in a grey-list company falls below 10 per cent during an income year, and the FDR method could otherwise be applied to that interest (which would give a nil amount as the person did not have an interest of less than 10 per cent on hand at the start of the year [see s EX 52(5)(b)], the person will be subject to tax on this interest under the normal rules (ie not under the FIF rules). Sections CD 36(2), CD 36(3) and EX 59(1B) also support this by excluding from the FIF rules those situations when a person has a FIF interest in a grey-list company of 10 per cent or more at the beginning of the year and the person would otherwise be able to use the FDR method [see TIB vol 20:3 (April 2008) at 114].

Note: The above situation, when an interest in a grey-list company falls below 10 per cent during the year, does not apply to portfolio entities, entities eligible to be portfolio entities and life insurers that hold interests in a foreign PIE equivalent. This is because the grey-list exemption does not apply to those managed fund type entities. For those entities, the FDR method applies regardless of the level of investment held [see also s EX 46(7)(b)].

Persons (other than portfolio investment entities (PIEs), superannuation schemes, unit trusts, life insurers and group investment funds) do not have an attributing interest in a FIF if their rights are an interest of 10 per cent or more in a grey-list FIF for the full year; or in other words, they have grey-list protection [s EX 35, see 850.145].

The relationship between when FDR can be used, and FIFs in grey and non-grey-list countries, is illustrated in the following diagram:

<table>
<thead>
<tr>
<th>FIF interest size</th>
<th>Less than 10%</th>
<th>Greater than 10%</th>
<th>Grey-list list available</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grey-list FIF</td>
<td>FDR can be used if FIF interest is less than 10% at any time in the year</td>
<td>FDR can be used if FIF interest is less than 10% at any time in the year</td>
<td>FIF interest must be 10% or greater for the full year</td>
</tr>
<tr>
<td>Non-grey-list FIF</td>
<td>FDR can only be used if FIF interest is less than</td>
<td>FDR can not be used for the year if the FIF interest is 10% or more at any time during the year</td>
<td>N/A</td>
</tr>
</tbody>
</table>

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FIF interest size | Less than 10% | Greater than 10% | Grey-list exemption available
---|---|---|---
| 10% at all times during the year |

In determining whether a person’s shareholding in a FIF is less than 10 per cent, they are deemed to hold any interests held by associated persons. This is designed to prevent persons holding FIF interests greater than 10 per cent disaggregating their interests among associated persons to bring themselves into the FDR method. Disaggregating interests among associated persons potentially also risks gift duty. Note: Gift duty has been abolished in relation to all gifts made on or after 1 October 2011 see 315 DUTIES AND LEVIES.

Individuals (including family and charitable trusts) may choose between using either the FDR method or the CV method for all their “less than 10 per cent” shareholdings in FIFs. Investors are likely to use FDR when their return exceeds five per cent, and CV when the return is less than five per cent. However, investors must take a portfolio approach to applying the FDR or CV methods. Section EX 46(8)(b) provides that a person is not allowed to use the FDR method for an attributing interest for an income year if the person uses the CV method for any other attributing interest that is a share in a foreign company for which the person would be allowed to use the FDR method (ie it is a less than 10 per cent interest). Thus, for less than 10 per cent interests, if a person wants to use the CV method (eg because their return is less than five per cent), the person will not be entitled to use the FDR method for their other less than 10 per cent FIF interests.

Non-individuals (eg companies and trusts that are not family or charitable) are not eligible to switch between CV and FDR. A company must use FDR if the interest is less than 10 per cent unless the company is precluded from using FDR because the share is treated as equivalent to debt. Otherwise, a company can only use CV if the interest is 10 per cent or greater. There is an exception for non-individuals wanting to use FDR when their interest is equal to or greater than 10 per cent: s EX 46(7)(b) allows a PIE or an entity eligible to be a PIE or a life insurer to use FDR regardless of the size of the interest if the FIF is a foreign PIE.

Importantly, the FDR method does not apply to offshore portfolio share investments that are equivalent to debt. The policy intent is that the FDR method should not be used for investments which are in substance debt instruments. Otherwise New Zealand residents could avoid New Zealand tax on any return on a debt instrument that exceeds five per cent.

There are six types of guaranteed return type shares (debt equivalents) that specifically do not qualify for the FDR method under s EX 46(10). These shares are referred to as non-ordinary shares and are:

(a) Fixed-rate foreign equity [s YA 1];
(b) Non-participating redeemable shares [s CD 22];
(c) An interest in a non-resident entity holding (directly and indirectly) assets comprising 80 per cent or more by value at a time of fixed rate shares or financial arrangements that are denominated in New Zealand dollars or are hedged (under a highly effective hedge arrangement) under NZIAS39 to achieve the effect of New Zealand dollars;
(d) An interest in a non-resident if the non-resident holds (directly and indirectly) assets of which 80 per cent or more by value at a time in the income year consist of fixed rate shares or financial arrangements and the FIF interest is denominated in New Zealand dollars, under NZIAS 39, is a hedged item having a value in New Zealand dollars governed by a highly effective hedge arrangement.
(e) Shares that involve an obligation:
   (i) Of another person to provide to the investor, directly or indirectly, through an arrangement, an amount exceeding the issue price of the share; and
   (ii) That is non-contingent or subject to a contingency that is sufficiently remote to be immaterial.
(f) A type that the CIR has determined under s 91AAO of the TAA to be an interest for which the FDR method may not be used.

One of the reasons given for the rules in items (c) and (d) above is to counter instances when the rule in item (e) above may not be effective. For example, if the investment is in a foreign bond fund that invests back
into New Zealand Government debt. The New Zealand resident investor would have a direct interest in shares, not debt disguised as shares.

For the purposes of applying the rule in s EX 46(10)(d) (item (e) above) Inland Revenue states that the Australian “economic substance” test for determining whether an instrument is debt or equity provides guidance for determining whether an investment involves a non-contingent obligation to return an amount to the investor that exceeds the issue price of the investment, and therefore should not have the FDR method applied to it, because the investment is essentially debt. Contingencies that are immaterially remote are ignored for the purposes of this rule. Guidelines issued by the Australian Tax Office (ATO) provide guidance on understanding what is an “effectively non-contingent obligation”. These guidelines note that regard should be had to the terms, conditions, and pricing of the instrument [see TIB vol 19.3 (April 2007) at 43].

Under s EX 46(11), the CIR has discretion under s 91AAO of the TAA to make a determination that an investment qualifies for the FDR method even when technically the FDR method is precluded by [s EX 46(10)(a) to (d)] the legislation. This may be appropriate for investments that have returns that are contingent or that the investment is closer to equity in nature rather than debt.

The authority given to the CIR under s EX 46(10)(e) to make a determination under s 91AAO of the TAA precluding use of the FDR method is to buttress the boundary between debt and equity and try to ensure that the FDR method only applies to investment in foreign portfolio equity, and not to investments in foreign entities that provide investors with a return similar to a New Zealand dollar denominated debt instrument.

When s 91AAO of the TAA was first enacted, the provision required the CIR to take into account the economic relationships created by the arrangement and the principles that the FDR method may be used to calculate FIF income from an arrangement giving an investor an interest in the business profits and losses of a FIF, and that the FDR method not be used when the arrangement gives the investor a return not dependent on the business profits and losses of the FIF.

To assist in interpreting these rules, Inland Revenue set out criteria in TIB vol 19:3 (April 2007) at 42 that will be considered for the purposes of making a determination under that provision. The criteria were:

(a) The proportion of the foreign entity’s assets that comprise debt or other fixed return instruments (such as fixed rate shares);
(b) The extent to which the entity’s investments comprising debt or other fixed rate instruments are denominated in New Zealand currency;
(c) In relation to investments of the entity that are not denominated in New Zealand currency, the extent to which the exchange rate risk has been removed by swaps, forward currency contracts or other derivatives;
(d) The whole arrangement, including any interposed entities or financial arrangements, in ascertaining whether the investment in a foreign entity provides investors with a return similar to a New Zealand dollar denominated debt instrument;
(e) The degree of credit risk of the entity’s debt investments is not a relevant factor in the determination process;
(f) The economic relationships created by the whole arrangement and the principle that the fair dividend rate method should only be used for an in-substance equity investment where the investor has an interest in the business profits and losses of a foreign entity. This is intended to provide sufficient flexibility to deal with cases close to the boundary.

However, the operative provisions of s 91AAO of the TAA were rewritten with retrospective effect from 1 April 2007 by the Taxation (Business Taxation and Remedial Matters) Act 2007, which altered the wording of the provisions. In particular, s 91AAO of the TAA now states that in making the determination the CIR may have regard to the criteria set out in s 91AAO(2). Thus, the CIR can make a determination that does not have regard to the statutory criteria of s 91AAO(2).

Accordingly, the approach taken in s 91AAO of the TAA leaves room for some uncertainty. Given the absence of material available on when the CIR may use the determination powers, the reference to the TIB criteria...
may be helpful for taxpayers when considering the circumstances in which the CIR may make a determination under s 91AAO of the TAA. It may also be observed that some of the criteria used in the TIB item also now appear in the replacement s 91AAO(2).

The provisions in s 91AAO(2) that the CIR may have regard to when making a determination are:

(a) The principle that the FDR method should not be used for attributing FIF interests that are economically equivalent to a loan denominated in New Zealand currency;

(b) The extent to which the assets of a FIF:
   (i) Are loans, fixed rate shares or arrangements with a fixed economic return;
   (ii) Are denominated in New Zealand dollars; or
   (iii) Have a value substantially unaffected by variations in currency exchange rates;

(c) The compliance costs incurred by the person required to use the FDR method;

(d) Arrangements affecting the assets of a FIF and interests held directly and indirectly in a FIF.

A person precluded from using the FDR method for an attributing interest because it comes within one of the five categories of debt equivalent shares or because a determination precludes its use, must use the CV method for that interest, or the DRR method if the CV method is not practical, because the person cannot obtain the opening market value for the interest [s EX 47]. Because CV must be used in these circumstances, a loss can be claimed under the CV formula.

The CIR has issued a number of determinations. These are located at: www.ird.govt.nz/technical-tax/determinations/other/.

Importantly, s 91AAO states that if the determination applies after the start of an income year, then it will not apply for that year. Thus, it is important when considering the application of any determination to check the application date.

(4) Cost method

The cost method is the back-up method to the FDR method. The cost method is available when [s EX 46(9)]:

(a) The person’s FIF interest (increased by interests held by associated persons) is less than 10 per cent. Consistent with the FDR method, if the interest is in a grey-list FIF the interests must be less than 10 per cent at any time during the year. Otherwise it must be less than 10 per cent at all times during the year to qualify.

(b) Use of the FDR method is allowed, but it is not practical because the person cannot determine the market value of the interest at the start of the year except by an independent valuation.

The cost method caters for less than 10 per cent interests in foreign companies where use of the FDR method is allowed, but market values of the attributing interest are not readily available (eg investments are in unlisted foreign companies).

A common situation when cost is likely to be used will be FIF interests held in private or closely-held foreign companies and the like. Even if resident in Australia, the Australian ASX listing exemption will not apply, and the shares are not likely to have a readily quoted market value.

(5) Comparative value (CV) method

A person may use the CV method for an attributing interest that is a share in a foreign company only if:

(a) The interest is 10 per cent or more at any time in the income year (for this purpose, a person’s interests are increased by any interest held by associated persons);

(b) The interest is a non-ordinary share (ie treated as debt) under s EX 46(10) for which the CV method must be used under s EX 47;

(c) The person is a natural person or the trustee of a trust that is a family or charitable trust. The type of trust is defined in the legislation as a complying trust established mainly for the benefit of natural
persons for whom the “gifting settlors” have natural love and affection (or did have natural love and affection when alive) or is mainly for the benefit of charitable organisations or trusts that qualify for an income tax exemption. All settlors of the trust that are “gifting settlors” [s EX 46(1)] must be natural persons or deceased persons.

When a person increases an interest to 10 per cent or more, FDR may still be used in that year if the FIF is resident in a grey-list country. However, if the FIF is not resident in a grey-list country, people who increase their interest to 10 per cent or more may have to use CV for that year as FDR will not be available.

(6) Deemed rate of return (DRR) method

The general rule states that DRR can not be used for interests in a FIF that are a “direct income interest” of less than 10 per cent. Thus, for FIF interests that are shares, DRR can only be used when the interest is 10 per cent or more. Even then, DRR can only be used if:

(a) It is not reasonably practical to use either the CV or AP methods;

(b) If the person is a natural person and at all times during the income year the total value of attributing FIF interests held by the person is $250,000 or less, determined either on the basis of the book value of the interest at the end of the previous income year if the DRR method was used, or the market value in any other case;

(c) It is required as the default method under s EX 48, or

(d) The person is required to continue to use that method by virtue of s EX 62. That is, when they do not qualify to be able to change the method of calculating FIF income away from the DRR method to another method.

However, there is one circumstance when DRR can be used for shares that are not interests of 10 per cent or more. Under s EX 47 the DRR method must be used if the person is precluded from using the FDR method for an attributing interest because the interest is equivalent to debt and it is not practical to use the CV method because the person cannot obtain the market value of the attributing FIF interest.

Thus, with the changes to the FIF rules made consequentially with the introduction of the FDR method, the use of the DRR method is likely to be very limited. Essentially, for FIF interests that are shares that are an interest of 10 per cent or more in a foreign company, DRR is only likely to apply as a back up to CV (when a person would otherwise use CV but cannot determine market value for example) or AP.

For FIF interests that are not shares, such as interests in foreign superannuation and life insurance (category 2 and 3 interests) DRR can be used without restriction, (recall s EX 46(4) only applies to FIF interests that are shares). However, again, with the deemed rate of return exceeding 10 per cent, it is unlikely people will choose this method over FDR.

(7) Accounting profits (AP) method

The accounting profits method may be used if:

(a) The FIF is a company;

(b) The interests in the FIF (or similar interests to the person’s attributing interest) were quoted on the official list of a recognised exchange or offered widely by the FIF to the public in one or more countries;

(c) The net after-tax accounting profits or losses are calculated under generally accepted accounting practice (or their equivalent in the country of residence of the FIF);

(d) The net after-tax accounting profits or losses are detailed in financial statements:

(i) Sent or made available to shareholders in the company;

(ii) Readily available to interested members of the public;

(iii) Audited by a chartered accountant (or accountant of equivalent standard in the FIF’s country of residence);
An accountant has given a standard unqualified audit opinion to the effect that the financial statements represent the income and financial position of the FIF to the standard normally required in the FIF’s country of residence;

(e) The net after-tax accounting profits or losses are calculated on a consolidated basis if the FIF has one or more subsidiaries;

(f) The net after-tax accounting profits or losses include any extraordinary items;

(g) The person has no reason to believe that the net after-tax accounting profits or losses of the FIF do not fairly represent the net after-tax profits for the accounting period;

(h) The FIF is not included in sch 25, Part C, which lists entities for which the AP method cannot be used; and

(i) The CIR has not concluded that the net after-tax accounting profits or losses do not fairly represent the net after-tax profits of the FIF for the accounting period.

Unlike the CV and DRR methods (which can only be applied to interests of 10 per cent or more), the AP method has no limit on the size of the interest and can be applied to interests greater or less than 10 per cent. This is because s EX 46 does not prohibit the use of the AP method for interests that would otherwise be eligible for the FDR method (ie interests less than 10 per cent). However, the AP method is still subject to the consistency rule requirements [s EX 46(1)] discussed above.

850.155(8) Branch equivalent (BE) method

Provided the requirements of s EX 46(3) are met, that is the FIF is a company and the person can supply information to the CIR to enable the branch equivalent income or loss calculations to be checked, there is no explicit statutory prohibition from using the BE method.

However, there are practical restraints on the use of the BE method as it requires the investor to have sufficient information to undertake the calculations required by s EX 50 (ie the branch equivalent income and loss calculations). Unless sufficient control can be exercised over the FIF it may be very difficult to do the calculations required for that purpose.

850.160 Default calculation method

Subject to the ability to use a particular FIF calculation method [see 850.155] a person can choose which FIF method they will use. However, when a method is not chosen, the FIF rules allocate a default calculation method. The default method does not prescribe the method that must be used. Rather, the default method provides calculation rules that give the CIR a basis for assessing an investor’s income arising from an attributable FIF interest (ie if no tax return is filed and the CIR wishes to prepare a default assessment).

For FIF interests that are shares that are an interest of less than 10 per cent, the FDR method if the FDR method is allowed under s EX 46(7). Otherwise, the cost method if it is not practical to use FDR.

For any other interest, such as those interests that are 10 per cent or greater or for which FDR is not permitted:

(a) The accounting profits method if that method is permitted under s EX 46(2) [see 850.155] and it is practical to use AP.

(b) The comparative value method: if it is practical to use it and the AP is not allowed or practical; or

(c) The deemed rate of return method: if neither the AP nor CV methods are allowed or practical.

The order in which the default methods are set out in the section is, other than the branch equivalent method, from the more accurate method of measuring FIF income to the least. It is not possible to set the branch equivalent method as a default method as that method requires significant input from the taxpayer.

Note: Section EX 48 does not appear to set a default rate for FIF interests that are category 2 and 3 interests (ie interests in foreign superannuation and life insurance). However, this was not the case under s EX 41, and would appear to be a drafting error. Regard should be had to the transitional rules in these circumstances.

850.165 Accounting profits method

Under the accounting profits (AP) method, FIF income or loss is calculated by the formula:
accounting profit or losses – foreign tax × income interest

Where “accounting profit or losses” is defined as the net after-tax accounting profits or losses of the FIF for the accounting period, and “foreign tax” is for the accounting period, the total tax paid on the FIF income for which the person is liable under the laws of the a country or territory outside New Zealand.

The income interest is calculated under the rules that apply under the CFC rules as if the interest in the FIF were an interest in a CFC: specifically, ss EX 8 to EX 11, EX 16 and EX 17, and EX 26.

Because the income interest is based on the CFC rules, the measurement of the interest will be either daily or quarterly. However, for the purposes of the AP method a taxpayer can elect under s EX 49(6) to use a simplified measurement of income interest method that measures an income interest at 31 March only. The election is made by completing their return of income on this basis. However, any such election is irrevocable and applies to all their attributing interests in that FIF in subsequent years. The anti-avoidance rules in ss GB 9 to GB 16 that restrict a person’s ability to vary the interest apply once the election is made.

When a person incurs a FIF loss under the AP method in excess of the economic or financial loss suffered by the person, the amount of the FIF loss is limited to the amount of the actual economic or financial loss. These rules are similar to those used in the CFC rules [see 850.60].

Under s OE 5, the branch equivalent tax account provisions apply to FIF income calculated under the AP method as if:

(a) The FIF income were attributed CFC income;
(b) The FIF were a CFC; and
(c) The FIF interest of the holder were an income interest.

The person with FIF income or loss calculated under the AP method can choose for the calculations to be undertaken in the currency of the FIF’s financial accounts or New Zealand dollars. If the foreign currency of the FIF accounts is used, the result is then converted into New Zealand dollars at the average of the close of trading spot exchange rates for the 15th day of each complete month that falls in the accounting period.

850.170 Branch equivalent method [s EX 50]

Foreign investment fund income or loss calculated under the branch equivalent (BE) method uses the same rules (with some modifications) as are used to calculate branch equivalent income or loss under the CFC regime. The rules for losses and tax credits also mirror those applying to an income interest in a CFC [ss DN 5(2), DN 7, DN 8, EX 50(8) and (9)]. Under s OE 5, the branch equivalent tax account regime is also extended to FIF income calculated under the BE method [see 850.175].

The BE method is regarded as the most accurate determination of a FIF’s income or loss under New Zealand tax rules. The other FIF income or loss calculation methods are really only estimates of the income a person derives through a FIF and can therefore be viewed as proxies for the BE method. The BE method, however, requires the investor to have sufficient information about a FIF to be able to use that method. A person would have to have the ability to exert some influence over the BE FIF to be able to access information sufficient to undertake the BE calculations. It is also a requirement in s EX 46 that the person can provide information to the CIR to be able to check any BE calculation.

Foreign investment fund income or loss is calculated under the BE method using the formula:

\[
\text{branch equivalent income or loss} \times \text{income interest}
\]

Where:

“Branch equivalent income or loss” is the branch equivalent income or loss of the FIF for the period, calculated by applying s EX 21 of the CFC rules as if the FIF were a CFC, and excluding any taxable distribution from a non-qualifying trust and any FIF income of the BE FIF, as is the case when branch equivalent income or loss of a CFC is calculated;

“Income interest” is calculated under the rules that apply under the CFC rules as if the interest in the FIF were an interest in a CFC [ss EX 8-EX 11, EX 16, EX 17, EX 26].
Similarly to a person with an income interest in a CFC, if a person incurs a FIF loss in excess of the economic loss suffered, whether because of a put or call option or any other reasons, the amount of FIF loss is limited to the amount of the actual economic loss. This also applies if the FIF loss is more than any corresponding economic loss suffered by the person because of the rules applying to calculate the person’s income interest. For a discussion on the equivalent CFC rules see 850.60.

When a FIF derives a taxable distribution from a non-complying trust, the taxable distribution is taxed directly to the person with the interest in the FIF as additional attributed FIF income, specifically the:

(a) The taxable distribution is excluded when calculating the branch equivalent income or loss of the FIF;
(b) The person has additional attributed CFC income calculated by multiplying the taxable distribution by the person’s income interest in the FIF; and
(c) The person is liable for income tax on the additional attributed CFC income at 45 per cent (the rate in sch 1, Part A, cl 4).

If the FIF has an interest in a foreign company, the person has additional FIF income or loss calculated by multiplying the interest of the person in the BE FIF by the FIF’s FIF income or loss. For this purpose the rules in s EX 58(4) and (5) apply as if the BE FIF were a CFC, and notwithstanding the rules in s EX 34 that could potentially apply to exclude the interest from the FIF rules because it is regarded for these purposes as a deemed income interest in a CFC.

The rules in ss EX 58(4) require the person to choose the FIF calculation method and apply the FIF calculation rules in ss EX 44 — EX 61 in the same way as they would if they held the interest in the underlying FIF directly. Essentially the scheme of the rules treats the BE FIF as though it were a New Zealand resident. Thus, the person with the interest in the BE FIF would need to consider the exemptions and FIF rules accordingly in relation to that interest. For example, whether the interest is an interest of less than 10 per cent and entitled to FDR, or whether FDR is excluded because the FIF interest is regarded as equivalent to debt in terms of s EX 46(10). If the BE FIF’s interest was 10 per cent or more the grey-list could apply to exclude attribution.

Interestingly, if the BE FIF were a CFC, the person would have to have an income interest of 10 per cent or more in the CFC before they had to calculate FIF income directly under the CFC rules from any FIF underlying the CFC. However, this is not the case with the BE FIF rules.

The loss quarantining rules in s DN 8 apply to any BE FIF loss that is determined under s EX 50(6) and (7).

850.175 Extension of branch equivalent tax account regime [s OE 5]
The branch equivalent tax account procedures available under the CFC regime also apply to FIF income calculated under the accounting profits or branch equivalent methods. It applies as if:

(a) The FIF income were attributed CFC income of the person;
(b) The FIF were a CFC; and
(c) The FIF interest were an income interest within the meaning of the CFC regime.

The extension of the branch equivalent tax account regime to AP and BE FIF interests and calculation methods is intended to avoid double taxation of dividend flows by allowing branch equivalent tax account credit balances to be used to offset dividend withholding payment or other liabilities.

A taxpayer holding an interest in a second tier FIF is allowed a branch equivalent tax account credit for tax paid under the FIF regime when a CFC or a FIF using the BE method is interposed between the taxpayer and the second tier FIF interest.

850.180 Comparative value method [ss EX 51, LE 1, LJ 1(3), LJ 2]
The comparative value (CV) method is one of the principal methods used to calculate FIF income. In general terms, the CV method can be used if the person’s FIF interest is 10 per cent or more. For people with FIF interests of less than 10 per cent (portfolio FIF interests) the FDR will be the principal method used.
FIF interests of less than 10 per cent may qualify for the CV method when natural persons (including trustees of family or charitable trusts) elect to use CV under s EX 46(6).

**Note:** Corporate trustees of family trusts do not disqualify the trust from using CV.

However, it would be expected that they will only elect to use CV when the return from their total portfolio is less than five per cent (otherwise FDR gives a lesser taxable result) [see 850.155]. CV is also the method required to be used when the FIF interests are treated as debt under s EX 46(10) [see 850.155].

The CV method taxes the increase or decrease (note the limits on losses under the CV method — see below) in the value of a person’s interest in a FIF over an income year, as a surrogate for the underlying income accumulated by the FIF. A person’s FIF income or loss is calculated on the last day of the person’s income year, using the formula:

\[
\text{FIF income or loss} = (\text{closing value} + \text{gains}) - (\text{opening value} + \text{costs})
\]

Where:

“Closing value” is the market value of the person’s FIF interest at the end of the income year, calculated using the exchange rate applying under s EX 57 for that previous year. The value is zero if the person has disposed of the interest or is applying another FIF calculation method to that FIF interest.

“Gains” is the total of all amounts that the person derives during the income year from holding or disposing of the interest. This includes any foreign withholding tax or amount allowed as a credit under s LE 1 (credit of tax for imputation credit) and s LJ 2 (tax credit for foreign withholding tax). The reference to s LE 1 includes imputation credits received under the trans-Tasman imputation rules.

“Opening value” is the market value of the interest at the end of the preceding income year. The value is zero if the person does not hold the interest at that time or was then applying another calculation method to that FIF interest.

“Costs” is the total of all expenditure that the person incurs during the income year in acquiring or increasing the interest. It also includes any income tax paid in the accounting period on the income of the FIF for which the person is personally liable under the laws of a country or territory outside New Zealand.

**Note:** “Cost” is further defined in s EX 68 [see 850.260].

In relation to “gains” in the formula in s EX 51, the scheme of the FIF rules is that foreign withholding tax on any dividends received from the FIF is allowed as a tax credit. However, in calculating the amount of the credit allowable, the credit is calculated on the FIF income: not the dividend. Thus, the foreign withholding tax allowed as a credit is included as a gain under the formula in s EX 51(4). Section LJ 1(3) provides that for the purposes of calculating the withholding tax credit, it is the FIF income that is used for this purpose, despite the fact that it is not otherwise taxable.

The reference to s LE 1 in the definition of “gains” is to ensure the gain is grossed up to include trans-Tasman imputation credits allowed as a credit to a person with a FIF interest in an Australian company.

Under s EX 59, when a person calculates FIF income or loss using the CV method, no dividend or income is otherwise deemed to be derived. However, aggregate amounts derived from holding or disposing of a FIF interest in excess of total FIF income in respect of that interest may [s EX 61, see 850.195] be assessable when the FIF interest is disposed — although the application of s EX 61 is now limited as it only applies to FIF interests held on 2 July 1992.

The acquisition cost of a FIF interest cannot be claimed as a deduction outside the FIF regime, nor can the interest be treated as trading stock [s EX 59(3) and (4)]. Holding costs are excluded as a cost under s EX 68(9). These provisions essentially ensure there is no double deduction available for the costs of acquiring and holding FIF interests subject to the CV method. For example, the cost of acquiring the FIF interest is accounted for only in the FIF formula, and any interest incurred on money borrowed to purchase the FIF interest is deductible under the ordinary rules, and not through the FIF income/loss formula.

The formula allows a deduction for expenditure incurred on the person’s behalf in acquiring a FIF interest as well as for expenditure directly incurred by the person. Therefore, only the proportion of the underlying...
income of a foreign superannuation scheme attributable to the FIF interest, and not the employer
ccontributions, is taxed as it accrues.

Because the comparative value method relies on an interest’s market value, it may not be possible to use this
method if market value of the interest is not available. In the case of life insurance and superannuation there
are rules in s EX 70 that may assist in certain circumstances. In relation to life insurance, a policy’s surrender
value may be used in determining the market value of the interest when the person becomes a resident
[s EX 64(4)] or if any one of the FIF exclusions ceases to apply [s EX 65(2)]. When the interest is a right to
benefit under a superannuation scheme, the person may use the costs incurred (by or for the person) up to
that time in acquiring the rights if it is not reasonably practicable to calculate actual market value and the
person has not derived any material gain from the rights up to that time.

Note: Under s EX 71, the rule in s GC 4 applies when FIF interests are acquired and disposed of in the
circumstances set out in that provision. Essentially s GC 4 buttresses the requirements to use market value
when FIF interests are acquired and disposed.

If the CV method gives a better result (ie a lesser income amount) for the taxpayer (natural persons and
trustees of family and charitable trusts with FIF interests of less than 10 per cent) than the FDR method, the
CV method is available for the investor to use. The option to use the CV method in these circumstances
essentially allows holder of portfolio interests in offshore shares to recognise any decline in the value of their
investment.

Thus, natural persons (including trustees of family and charitable trusts) may choose between using either
the FDR method or the CV method for all their portfolio shareholdings in FIFs. Investors are likely to use
FDR when their return exceeds five per cent, and CV when the return is less than five per cent. However,
investors must take a portfolio approach to applying the FDR or CV methods. Section EX 46(8)(b) provides
that a person is not allowed to use the FDR method for an attributing interest for an income year if the person
uses the CV method for any other attributing interest that is a share in a foreign company for which the person
would be allowed to use the FDR method (ie it is a less than 10 per cent interest). Thus, for less than 10 per
cent interests, if a person wants to use the CV method (eg because their return is less than five per cent), the
person will not be entitled to use the FDR method for their other less than 10 per cent FIF interests.

However, in the above circumstances, when a taxpayer chooses between CV and FDR for their less than
10 per cent interests, the taxpayer cannot claim a FIF loss under the CV method — this is reduced to zero
under s EX 51(8). Under that provision, no person with a FIF interest of less than 10 per cent can have a loss
under the CV method. However, taxpayers with FIF interests that are treated as debt (referred to as non-
ordinary shares in the legislation) can have a FIF loss, as they are subject to the full rigors of the CV method
for both profits and losses.

Note: The rule in s EX 51(8) applies to all forms of FIF interest for which FDR can be used (ie FIF interests
in foreign life insurance and superannuation are also subject to this rule). Section EX 51(8) as enacted only
applied to portfolio interests, which did not include interests in foreign life insurance and superannuation.
Section EX 51(8) was amended with application to the 2009-2010 and later years to ensure that if a CV loss
arose from portfolio interests or interests in foreign life insurance and superannuation, that the losses would
be reduced to zero.

Non-individuals (ie companies and trusts that are not family or charitable) are not eligible to switch between
CV and FDR. A company must use FDR if the interest is less than 10 per cent unless the company is precluded
from using FDR because the share is treated as equivalent to debt under s EX 46(10). Otherwise, a company
can only use CV if the interest is 10 per cent or greater.

850.185 Fair dividend rate method [ss EX 52, EX 53]

(1) Overview

The fair dividend rate method (FDR) method applies to portfolio investments (ie direct income interest of
less than 10 per cent) in offshore shares and interests in foreign superannuation and life insurance policies.
That is, it applies to all categories of FIF interest as set out in s EX 29, except in the case of shares in a foreign
company s EX 46(7) limits the use of the FDR method to interests of less than 10 per cent. For a full discussion on the limits on the use of the FDR method see 850.155.

In its simplest form FDR is a tax on the market value of a persons stock of attributing FIF interests. The FDR method imposes income tax on five per cent of the opening market value of a persons attributing FIF interests held at the beginning of the year.

Taxpayers who are natural persons and trustees of family and charitable trusts can, however, elect to use the comparative value (CV) basis. Therefore, if these investors can show their total actual return is lower than five per cent, they can switch their calculation method to the CV basis such that the lower amount will be the amount subject to tax. No loss is available under the CV method in these circumstances. The actual return is calculated under the comparative value method [s EX 51].

For non-natural persons (other than family and charitable trusts) such as companies, the FDR method imposes a five per cent flat tax charge on the opening market value of the FIF interests. No adjustment is made if the overall return is less than five per cent. Thus, even in years when the investments are in loss, non-natural persons must pay tax on a notional return of five per cent. Non-natural persons that value investor’s units may apply the income calculation formula for periods that link to their unit valuation periods. For example, they can calculate income daily, monthly or quarterly [see 850.190].

The FDR method ignores acquisitions and disposals of shares during a year, except when an acquisition and disposal of a FIF interest is made within the income year. FIF interests acquired and disposed during an income year, referred to as “quick sales” are subject to tax on the lower of five per cent of the average cost of the FIF interest acquired and sold, or the actual gain (based on sales less average cost). Otherwise there is no FIF income calculated in relation to shares acquired (or deemed to be acquired under s EX 65 when an exemption ceases), after the start of the income year. Conversely, there will be full attribution on foreign shares held at the start of the year that are disposed during the year.

Under ss CD 36 and EX 59 dividends are not taxed separately, although any withholding tax credit accompanying the dividend and any imputation credit received under the trans-Tasman triangular rules is still available as a credit — although this is not that clear in the legislation.

**Note:** If a person acquires a FIF interest part way through a year, any dividend received in the intervening period will not be taxable if the person elects (by furnishing a return of income) to use the FDR method in respect of that interest. Thus, ss CD 36 and EX 59 will apply and the dividend will not be subject to tax under the ordinary rules. However, there is nothing stopping the person using the CV method in respect of that FIF interest if they are eligible, and, if they did elect the CV method, then ss CD 36 and EX 59 would apply to the dividend.

FIF interests that are akin to debt (ie have non-contingent returns), are not eligible to use the FDR method, and must use the comparative value (CV) method [ss EX 46(8) and EX 46(10)]. The CIR is authorised to issue determinations that an investment is akin to debt and not eligible for FDR [s EX 46(10)(c) and TAA, s 91AAO]. A determination can also be issued if a FIF interest is caught under the broad definition of debt used for these purposes, but should be taxed under the FDR rules [s EX 46(11)]. If the CIR issues a determination that specifies a type of attributing FIF interest that may use or may not use the FDR method, this determination must be notified in the *Gazette* within 30 days of the date of the determination and be published in an Inland Revenue publication as soon as possible.

FIF interests that are fixed rate shares [defined in s LL 9] or non-participating redeemable preference shares [defined in s CD 22] are specifically excluded from the FDR method, as are investments in FIF interests in an entity whose assets comprise 80 per cent or more by value of financial arrangements denominated in New Zealand dollars.

Attributing FIF interests that are shares with the following characteristics will also be denied the FDR method. The shares involve an obligation:

(a) Of another person to provide to the investor an amount exceeding the issue price of the share;  
(b) Is direct to the investor or indirect through an arrangement; and  
(c) That is not contingent or subject to a contingency that is sufficiently remote to be immaterial.
Together, ss EX 46(10) and 91AAO of the TAA provide very wide scope for the CIR to determine that an attributing FIF interest has to use the CV method [see 850.155].

(2) Application to natural persons and family trusts

Natural persons and trustees of family trusts (eg complying trusts established mainly for the benefit of a natural person whom the settlor has natural love and affection, or mainly for the benefit of a charitable organisation or trust, and with no settlor who is not a natural person or a deceased person, and not including a superannuation scheme) are allowed to calculate their FIF income for portfolio interests under the CV method.

Note: Corporate trustees of family trusts do not disqualify the trust from using CV.

Thus, if the CV method gives a better result for the taxpayer than the FDR method, the CV method is available for the investor to use. The option to use the CV method in these circumstances essentially allows holder of portfolio interests in offshore shares to recognise any decline in the value of their investment. However, the taxpayer cannot claim a FIF loss — this is reduced to zero under s EX 51(8).

The comparative value formula is contained in s EX 51(1) and is:

\[
\text{closing market value of shares held} + \text{gains} - \text{opening market value of shares held} + \text{costs}
\]

Where:

“Gains” is defined as all amounts derived during the year from holding or disposing of the shares. That is, dividends (including withholding tax credits) and sales proceeds.

“Costs” is the expenditure incurred on acquiring or increasing the interest.

(3) The FDR income calculation

The FDR calculation differs between taxpayers that are unit valuing funds (essentially managed funds) and others. The principal difference is the period over which the FDR income calculation is applied. For unit valuing funds it is applied over the period or periods in which the fund measures the value of investors’ interests. For other taxpayers, it is an income year calculation (unless they elect to apply the daily valuation rules).

Section EX 52 provides the basis for people that are not unit valuing funds. Section EX 53, provides the FDR rules for unit valuing funds. In most cases, particularly natural persons, it would be expected that the FDR method set out in s EX 52 will be used. However, people who are not unit valuing funds can choose to apply the method in EX 53. This allows taxpayers other than unit valuing funds to use the daily basis. The key advantage is that the quick sale rules will not apply to that person, but the trade off is the requirement to undertake daily FDR calculations. It is unlikely that many taxpayers will use the daily valuation method, which appears to be designed more for investment entities.

For FIF interests that are subject to a returning share transfer [see 1340.90], if an attributing FIF interest is an original share subject to a returning share transfer, the attributing interest is treated as being held by the share supplier. Thus, share-lending transactions are disregarded for all FDR purposes.

(4) The FDR formula [s EX 52]

The following formula is applied to the total of the person’s FIF portfolio interest in shares:

\[
0.05 \times \text{opening} + \text{quick sale adjustment}
\]

Where:

“Opening” is the total market values of the attributing FIF interests for which the person holds at the beginning of the income year, not including FIF interests that form part of an interest of 10 per cent or more in a grey-list FIF at the beginning of the income year. The exclusion for FIF interests of 10 per cent or more in a grey-list company at the start of the income year allows interests that exceed 10 per cent at that time, but reduce to below 10 per cent during the year to be excluded from the FIF rules altogether for that year. Effectively this treats the value of that interest at nil at the beginning of the year.
“Quick sale adjustment” is required only when, in the income year, the taxpayer disposes of or reduces their attributing interest in the FIF after acquiring it or increasing it. The quick sale adjustment is zero in any other case. This is discussed in more detail below.

Ignoring quick sale adjustments, the FDR income for the year will be no more than five per cent of the opening market value of the investment.

Example 1 (Standard case):
Steve holds shares in a German company that has an opening market value of $70,000. During the year the company paid a dividend of $400 less $67.50 withholding tax. Steve also holds shares in a company in Spain that has an opening market value of $12,000 and in a Canadian company that have an opening market value of $8,000. Steve’s income is $90,000 × 0.05 = $4,500. The dividend of $400 is not taxed [ss CD 36 and EX 59], although Steve is allowed a foreign tax credit of $67.50 under ss LJ 1(3) and LJ 2). Steve could choose to use the CV method if the formula in s EX 51 gave a lower FIF income amount.

Example 2 (Standard case modified for purchases and sales after the commencement of the income year):
Same facts as Example 1. However, assume Steve also purchased some additional shares in the Canadian company for $4,000 and sold some shares in the English company to pay for the Canadian shares. Steve’s income is unchanged, it remains $90,000 × 0.05 = $4,500 with an allowance for the foreign tax credit of $67.50. This is because the FDR formula only looks at the stock of portfolio interests in offshore companies on hand at the beginning of the year. Any changes made after the year commences are not taken into account unless they are subject to the quick sale adjustment. The quick sale adjustment does not apply here as in each case there was not an acquisition or disposal of an interest in the FIF concerned in the income year.

Example 3 (Total return exceeds five per cent):
Imogen holds offshore shares that have a market value $60,000 at the start of the year. At the end of the year the shares have a market value of $67,000. A dividend of $200 is received during the year. Imogen’s total gain for the year is $7,200. However, her taxable FIF income based on the FDR method is $60,000 × 0.05 = $3,000. The dividend is not taxed separately.

Example 4 (Total return between zero per cent and five per cent):
John and Sue, a couple in a de facto relationship, own shares in a Scottish company with an opening market value of $140,000. The shares were purchased from funds in their joint bank account. The shares have a market value of $142,800 at the end of the year. A dividend of $700 is also received. Under the FDR method, John and Sue would each have $3,500 to return as FIF income, being $70,000 × 0.05. While John and Sue also have a dividend of $350, this is not taxed separately as a dividend, but rather is subsumed by the FDR calculation. However, their respective total returns are $1,750: being half the gain of $2,800 plus half the dividend of $700. This represents a return 2.5 per cent. If John and Sue each choose to use the comparative value method for their total portfolio of FIF interests, they will pay tax on the lower FIF income amount. Although not relevant for the example, if the purpose of determining whether the interest is an interest of 10 per cent or more, John and Sue’s interests are looked at collectively as they are associated persons. If collectively their interests constituted an interest of 10 per cent or more, the interest could not be taxed under the FDR method. However, they would then be entitled to the grey-list exemption in s EX 35 if their interest was an interest of 10 per cent or more for the full year.

Example 5 (Overall loss):
Angela has a portfolio interest in a French company. At the start of her tax year the interest had a market value of $112,000. However, this reduced to $102,000 at the end of the year. A dividend of $1000 was also received. Angela also had other FIF portfolio interests that made gains of $2,000 and $4,000. Overall, under the formula in s EX 51 (the CV method), Angela made a net FIF loss of $3,000 for the tax year. Accordingly, by electing to use the CV method, no tax is payable for the year for her FIF interests. However, no loss is available either under ss EX 51(7) and (8), which reduces the loss to zero.

Note: While s EX 62(8) allows a natural person (or the trustee of a trust established mainly for the benefit of family or a charitable organisation), to change their FIF income calculation methods from the FDR method to the CV method (and vice versa), taxpayers will generally only want to use the CV method if the total return on the portfolio is less than five per cent. Although there is no rule preventing use of the CV method if that gives a higher taxable income amount, FDR caps the FIF income to five per cent.

Note: The rule in s EX 46(8)(b) prevents a person from using FDR method for part of their portfolio and the CV method for other parts, and thus cherry picking the most desirable results on an interest by interest basis. Effectively, it is not possible to use the FDR method for some FIF interests that produce a return in excess of five per cent (and get the benefit of the five per cent cap under that method), and the CV method for FIF interests that produce a return lower than five per cent. For all other taxpayers (ie taxpayers other than natural
persons and family trusts), there is no general ability to elect to use the CV method and the taxpayer will pay tax based on the opening value multiplied by five per cent.

(5) **Quick sale adjustment**

The FDR income calculation formula focuses on the value of offshore portfolio shares as at the commencement of a person’s tax year. Rules (known as quick sales rules), exist to stop people purchasing shares and selling down around balance date, and were thus developed to buttress the FDR rules. That is, in the absence of the quick sales rules, taxpayers with a standard balance date could purchase shares after 1 April and sell before the following 31 March with no tax impost. Nor would the shares be reflected in the value of the shares on hand at the start of the next tax year.

The quick sale rules achieve this by targeting shares purchased and disposed of within the same year (ie for standard balance date taxpayers, shares purchased after 1 April and sold before the following 31 March). The rule does not apply to deemed sales and acquisitions when there is a change in the method of calculating FIF income or loss from FDR to CV, and vice versa, under s EX 63(5) and the rule in s EX 67 that applies when a person first enters the FIF rules.

These share transactions will be taxed on the lower of five per cent of the average cost of the FIF interest (the peak holding adjustment) and the total gain on all FIF interests purchased and sold during the period (taking a pooled approach) — calculated by taking the total amount derived from holding and disposing the interest (thus including dividends) and subtracting the average cost of the FIF interests so acquired and disposed.

The quick sale rule requires taxpayers (who purchase and sell an interest in a FIF in an income year) to undertake two calculations: the peak holding adjustment and the quick sale gain amount. Essentially this is comparing an amount that would have been taxable FIF income had the acquired shares been taxed under the FDR rules (the peak holding adjustment) with the gain on sale (the quick sale gain amount). The lesser of these two amounts represents the taxable quick sale adjustment.

Another way of thinking about this is that the quick sales adjustment will never exceed the peak holding adjustment: which is five per cent of the average costs of the shares purchased and sold in that year. In essence, for natural persons and family and charitable trusts at least, this is consistent with the FDR philosophy that taxes the lesser of five per cent of the value or the actual gain.

The peak holding adjustment is the total of the amounts calculated for each foreign company using the following formula [s EX 52(8)]:

\[
5\% \times \text{peak holding differential} \times \text{average cost}
\]

Where:

“Peak holding differential” is the lower of:

(a) The difference (in numbers of shares) between the largest number of shares held in the FIF in the tax year and the number of shares held at the beginning of the year; and

(b) The difference (in numbers of shares) between the largest number of shares held in the FIF in the tax year and the number of shares held at the end of the year.

“Average cost” is defined to be (assuming no share reorganisation) [see 850.200] the total amount of expenditure that the person incurs during the income year in acquiring or increasing the attributing interest in the FIF divided by the total for the income year of the increase in the attributing interest in the FIF for each acquisition or increase.

The quick sale gains is the greater of zero and the total of the amounts calculated for each attributing FIF interest that is both acquired and disposed of in the income year using the following formula [s EX 52(12)]:

\[
\text{return} - (\text{interest} \times \text{average cost})
\]

Where:

“Return” is the total amount derived by the person during the year from holding or disposing of the interest:

“Interest” is the shareholding that is both acquired and disposed of in the income year:
“Average cost” is the total amount of expenditure that the person incurs during the income year in acquiring or increasing the attributing interest in the FIF divided by the total for the income year of the increase in the attributing interest in the FIF for each acquisition or increase.

Example 1 (Standard case):
Bob owns 21,000 shares in a FIF. During the year Bob purchased two parcels of additional shares, one of 2,000 and a later one of 3,000. Bob subsequently sold 7,000. The peak holding adjustment is the lesser of 5,000 (being the difference between the largest number of shares held less shares at the beginning of the year: 26,000 – 21,000) and 7,000 (being the difference between the largest number of shares held less shares at the end of the year: 26,000 – 19,000). The “average cost” for the purposes of the peak holding adjustment formula is the total amount of expenditure that the person incurs during the year in acquiring or increasing the attributing interest in the FIF divided by the total number of shares acquired during the year. Using the average cost approach avoids the need to trace the cost of the shares that are subsequently sold. The first parcel of shares acquired of 2,000 was acquired at $1.10 per share and the second parcel of 3000 at $1.20 per share. Thus, the average cost is $5,800 / 5,000 is $1.16. The peak holding adjustment for these transactions is thus 0.05 × $500 × $1.16, which is $290.

The amount of $290 is compared to the quick sale gain amount. The quick sale gain amount, determined under s EX 52(12), is the greater of zero and the aggregate of the gains made from holding and disposing of these shares in the income year. The “holding gains” represent any dividends received that relate to the quick sale shares and the “disposal gains” the total gain on sale, that is, sale proceeds less average cost incurred in acquiring the FIF interests. The 7,000 shares were sold for $1.24 per share. Bob advised that a dividend of $1,000 was received after he held all 26,000 shares. The quick sale amount (holding gains) is thus the prorated dividend attributable to the shares acquired and sold (5,000/26,000 × $1,000) which gives a holding gain of $192.30 plus the gain on sale of ($6,200 - $5,800) $400 (the disposal gain), which gives a quick sale gain amount of $592.30. The lesser of the peak holding adjustment and the quick sales gain is then added to the FDR amount calculated for the 21,000 shares on hand at the start of the year as calculated under ss EX 52(3) to (6). In Bob’s case, $290 is the lesser amount and constitutes the “quick sales adjustment” in s EX 52(3).

In calculating the quick sales gain amount, s EX 52(14) requires a last in first out or LIFO approach to be used to determine whether shares in a foreign company sold in a year were purchased in that year. Thus, in the examples above, of the 7,000 shares sold, the gain was calculated on the 5,000 last acquired (i.e. 3,000 @ $1.20 and 2,000 @ $1.10). This is consistent with an approach that seeks only to measure gains on FIF interests acquired and disposed of during the year.

Example 2 (Quick sale rules when both gains and losses):
Scotty is preparing his return of income for a tax year and gathers the following information to return his income attributable to his FIF interests. Market value of his foreign share portfolio (excluding his exempted shares) at the beginning of the income year is $120,000. Of this, $20,000 related to 22,000 shares in Biomunch Ltd and $30,000 to 60,000 shares in Agripop Ltd. During the year he purchased an additional 3,000 shares in Biomunch Ltd for $1.05 per share and sold 1,000 for $1.05 per share. He also purchased 5,000 shares in Agripop Ltd for $1.50 and sold 7,000 for $1.25. Scotty received a dividend of $500 from Agripop Ltd in respect of his 60,000 shares. No dividend was received from Biomunch Ltd. The FDR calculation is:

\[
0.05 \times \text{opening value} + \text{quick sale adjustment}
\]

Scotty determines that his standard FDR income for the year to 31 March, being 0.05 × opening (0.05 × $120,000), is $6,000. However, to this he needs to consider whether there is an amount attributable to his quick sale adjustment (i.e. the shares he acquired and disposed of during the year). The quick sale adjustment taxes the lower of the peak holding adjustment and the quick sale gains. Scotty calculates his peak holding adjustment as follows:

\[
0.05 \times \text{peak holding adjustment} \times \text{average cost}
\]

Peak holding adjustment is the lesser of the difference between the largest number of shares held less shares held at the beginning of the year, and the difference between the largest number of shares held less shares held at the end of the year. For Biomunch Ltd, Scotty’s largest holding was 25,000, with 22,000 held at the start of the tax year and 24,000 at the end. Thus, the peak holding is 1,000, being the lesser of the largest holding and the shares held at the start and end of the tax year. The average cost of the shares sold was $1.05/share. For Agripop Ltd, Scotty’s largest holding was 65,000, with 60,000 held at the start of the tax year and 58,000 held at the end. Thus, the peak holding is 5,000 for Agripop Ltd, with an average cost of $0.50/share. For Biomunch Ltd the peak holding adjustment is: 0.05 × 1,000 × $1.05 = $52.50. For Agripop Ltd the peak holding adjustment is: 0.05 × 5,000 × $0.50 = $125. Scotty’s peak holding adjustment is the total of the amounts from applying the peak holding adjustment formula for both Biomunch Ltd and Agripop Ltd, which is $177.50. Scotty compares this to his quick sales gain amount.

The quick sale gain amount is determined by ss EX 52(12) and (13) as the greater of zero and the total (aggregate) amounts derived from holding or disposing of each FIF interest less the average cost incurred in acquiring the interest sold. For Biomunch Ltd the quick sale gain is (sale proceeds of $750 less their cost of $1,050) a loss of ($300). For Agripop Ltd, the quick sale gain is (sale proceeds of $6,250 less their cost of $2,500) $3,750. No part of the $500 dividend received relates to the shares sold: the dividend was paid on the shares held at the commencement of the year and is subsumed by the FDR method — recall that dividends received from a FIF are not taxable outside the FIF rules [s EX 59 and CD 36]. Combining the quick sale results for...
Biomunch Ltd and Agripop Ltd gives a total quick sale gain of ($3,750 - $300) $3,450. The quick sales adjustment for the purposes of the principal FDR formula in s EX 52(3) is the lesser of $3,450 and $177.50. The FDR income is then $6,177.50.

Note: When calculating the quick sale adjustment in s EX 52(3), the formulas are applied to each FIF interest, but the results are aggregated when comparing the peak holding adjustment and quick sale gain amount, as was done in the example above.

Suppose the quick sale gain on the Agripop Ltd shares yielded an overall loss instead. If this were the case the outcome would be that Scotty’s FDR income would be $6,000, as the quick sale adjustment in the formula in s EX 52(3) is the lesser of the peak holding adjustment and the quick sale gains. The quick sale gain amount cannot be less than zero under s EX 52(7). For the purposes of the FDR formula in s EX 52(3) the quick sale adjustment would be zero.

Example 3 (Quick sale gains and losses, but overall return on portfolio less than five per cent):

Suppose the value of Scotty’s foreign portfolio shares had reduced to $112,000 during the year. Under s EX 50(8) a natural person, or the trustee of a trust established mainly for the benefit of family or a charitable organisation, may change their FIF income calculation methods from the FDR method to the CV method and vice versa. If the overall return from the portfolio was less than five per cent, the CV method will tax the lower amount — although a loss is not available. The comparative value formula under s EX 51 is:

\[(\text{closing value} + \text{gains}) - (\text{opening value} + \text{costs})\]

Closing value is $112,000, the gains are $10,000 (ie gains = sale proceeds + dividends = $750 + $8,750 + $500 = $10,000), opening value is $120,000, and costs are $3,550 ($2,500 + $1,050 = $3,550). The CV calculation is therefore:

$112,000 + $10,000 - $120,000 + $3,550

Overall the portfolio made a loss of ($1,550) which s EX 51(8) is reduced to nil. In this instance it would be in the taxpayer’s interest to use comparative value for this year, as the FDR result is $6,177.50.

Note: When undertaking the CV method calculation to determine if the overall result is lower under FDR (which includes quick sale gains) or CV, the “gains” figure includes all gross gains made, not just those gains that are considered for the purposes of the quick sale adjustment. That is, it includes gains made on sales when the sale relates to purchases in previous income years and not caught under the quick sales rules. This is illustrated in the example above that included the gains of $8,750 from the sale of the 7000 Agripop Ltd shares, when only 5000 Agripop Ltd shares were subject to the quick sales adjustment.

Note: When using CV in respect of an attributing FIF interest that would otherwise qualify for the FDR method (ie because it is a portfolio interest), it must be used for the total portfolio [s EX 46(8)(b), see 850.155].

(6) Other tax implications [ss CD 36, EX 57, EX 59, LJ 1(3) and LJ 2]

In a general sense, the FDR method meshes well with the provisional tax rules, as provisional taxpayers should be able to determine their provisional income from their FIF interests (subject to the FDR rules), with relative ease. Especially, if there are no quick sales. By default, the provisional tax rules take the previous year’s residual income tax and increase that by five per cent for the purposes of the current year’s provisional tax. Taxpayers using the standard uplift method to pay provisional tax should be paying sufficient provisional tax to cover FIF obligations under the FDR method.

(7) Dividends and withholding tax credits [ss CD 36, EX 59 and LJ 2]

Dividends derived by a person with an interest in a FIF are not taxed separately if the person uses the FDR, CV, DRR or cost methods. Rather, the dividend is subsumed by the FIF income calculation method. While dividends received from an attributing FIF interest are not taxed, a foreign tax credit can still be claimed for any withholding tax deducted from the dividend. The withholding tax credit is calculated by reference to the FIF income returned. When a person is using the FDR method, then this will always give rise to income. However, if the person is a natural person or a trustee of a family trust, and they have opted to use comparative value for as their FIF calculation method and that produces a loss that is limited to nil under s EX 51, (then providing there is an overall New Zealand tax payable position) a credit for foreign tax may still be claimed for those FIF interests that show a positive return using the CV method. This is because foreign tax credits are calculated on a segment of foreign sourced income. Not the net foreign income position.

A purpose of s EX 59 (and the associated belts and braces provision, s CD 36) is to ensure that once an interest is subject to tax under the FIF rules that there is no additional tax liabilities arising or additional deductions allowed. Thus, dividends, or gains taxable on FIF interests under s CB 4, received from an interest in a FIF are not taxed separately [s EX 59(2)]. Similarly, no deduction is allowed if another provision of the Act could...
potentially also apply [s EX 59(3)]. Questions often arise in relation to interest incurred in acquiring FIF interests. Section EX 59 does not deny a deduction for the interest expense. Section EX 68 does exclude interest from the measurement of “cost” for the FIF rules, but again, this does not prohibit a deduction under ordinary rules.

850.190 Application of fair dividend rate to managed funds [s EX 53]

For New Zealand managed funds (ie unit trusts and superannuation funds — referred to as “funds” [defined in s EX 53(1)(b)]) and people who elect under s EX 53(1B) to apply the FDR rules on a daily basis (collectively referred to as the interest holder), the five per cent fair dividend rate is applied to the FIF portfolio for each unit valuation period used by the entity to determine the value of their attributing FIF interests, or of the interests of investors in the entity.

The term unit valuation period is defined as each period within the income year of the entity for which it determines the value of the attributing interests or of investors’ interests in the entity. That is, the period that either the entity uses in valuing its interests, or those of the investors in the entity. For people other than funds that elect to calculate their FDR income on a daily basis, the unit valuation period is daily [s EX 53(1B)(c)(i)].

For an entity that calculates the value of its investments and those of their investors units on a regular basis, the taxable income for each valuation period (which could range from a day to a quarter) is calculated using the following formula in s EX 53(3):

\[
5\% \times \text{opening} \times \left(\frac{\text{number of days in the period}}{\text{number of days in the income year}}\right) + \text{quick sale adjustment}
\]

Where:

“Opening” is the total market value of FIF interests for which the person uses the FDR method at start of the relevant period.

\textbf{Note:} As with the formula in s EX 52, this does not include FIF interests that form part of an interest of 10 per cent or more in a grey-list FIF at the beginning of the income year. FIF interests of 10 per cent or more in a grey-list company at the start of the income year that reduce to below 10 per cent during the year are excluded from the FIF rules altogether for that year. Effectively this treats the value of that interest at nil at the beginning of the year.

“Period” is the number of days in the unit valuation period, and “year” is the number of days in the income year.

By applying the formula to the interest holders’ valuation period, it essentially means that the FDR applies to an average value of the interest holders’ portfolio of foreign share investments over the year. Inland Revenue have advised that the values that are used by managed funds for unit pricing purposes are acceptable to them for purposes of applying the fair dividend rate method provided a consistent approach is taken [see TIB vol 19:3 (April 2007) at 37].

The same quick sale adjustment applies to taxpayers covered by s EX 53 as it does to others, and thus the discussion on quick sales adjustments for the purposes of s EX 52 is just as relevant to quick sales adjustments under s EX 53. The only difference is that the quick sales adjustment applies to the unit valuation period used by the interest holder, instead of an income year basis. Thus, if a managed fund values its units quarterly, then the quick sales rules are applied to the quarter. An exception applies to interest holders that have a unit valuation period of one day, (ie an entity that values investors units daily or a person who is not a fund who has elected under s EX 53(1B) to do daily valuations). In this case, as the FDR formula is applied to the daily value of the portfolio of attributing FIF interests, all changes in the value of the portfolio are picked up in the FDR formula, no quick sales adjustment is necessary [s EX 53(8)].

\textbf{Example:}

SuperInvestor fund values its units monthly. Each month it is required to apply the FDR rate to the market value of its portfolio of foreign shares. In one month the SuperInvestor fund acquires and disposes of some shares to take advantage of an opportunity to make a gain on some shares the fund manager regarded as under valued. The market value of the fund as at 1 June was $14 million. The fund had 100,000 shares in Undervalued Foreign Company Ltd. During June, it acquired an additional 40,000 shares
in UVC Ltd at $5 and disposed of 20,000 at $7. The quick sale adjustment is the lesser of the peak holding adjustment and the quick sales gain amount. The peak holding adjustment is:

\[ 5\% \times \text{peak holding differential} \times \text{average cost} \]

Peak holding differential is calculated under s EX 53(12), as the lesser of the difference between the largest holding and the holdings at the start and finish of the unit valuation period, which is 20,000 shares. Average cost is $5. The peak holding adjustment is thus

\[ 5\% \times 20,000 \times $5 = $5,000. \]

The quick sales gain is $40,000 (ie the sales proceeds of $140,000 less the average cost of 20,000 \(\times\) $5). Thus, the quick sales adjustment is $5,000 and is added to the income amount calculated for that unit valuation period. The FDR income for June is then:

\[ 5\% \times $14,000,000 \times 30/365 + $5,000 = $62,534.25 \]

Managed funds and entities other than natural persons and certain family trusts are not able to access the comparative value method for less than 10 per cent FIF interests, so they cannot switch to that method if the value of its portfolio reduces.

850.195 Cost method [s EX 56]

(1) Overview

A new cost-based method (a variant of the FDR method) is available for portfolio interests when it is not practical to obtain a market value and use the FDR method [s EX 46(9)]. Although s EX 46(9) limits the application of the method to interests of less than 10 per cent for interests in foreign companies, it is otherwise silent on category 2 and 3 interests (foreign life and superannuation).

However, while there seems to be nothing in principle stopping the application of the cost method to category 2 and 3 interests, the method is principally designed to cater for shares in foreign companies not listed on an exchange, and thus do not have readily identifiable market values as required by the FDR method.

Although there are a number of options for valuing the initial opening value, in general it would be expected that taxpayers would use the independent valuation option as the initial cost base when the interest was not an attributing FIF interest for the person for the previous income year. The valuation is a one-off valuation that allows investors to commence applying the cost method. However, the rules allow a revaluation of the attributing FIF interest every five years if the cost base is getting out of alignment with the actual value of the interest, for example, if the value decreased. No adjustment to prior year’s FIF income arises if a revaluation is undertaken and the value is lower than that used in prior years to calculate FIF income under this method: so it is important that the initial valuation is undertaken with due care.

The key features of the cost method are:

(a) It taxes five per cent of the cost (referred to as opening value in the legislation) of the portfolio investment each year;

(b) Cost is automatically increased by five per cent (being the deemed FIF income of the previous year) each year as a proxy for the increase in value of the interest;

(c) The cost base in each subsequent year is adjusted for sales and purchases in the previous year. If shareholding size has increased, the cost base is increased accordingly, similarly if shareholding is decreased;

(d) No tax liability arises in the year the interest is acquired (similar to FDR method), as there is no cost base at the beginning of the year;

(e) Dividends are not taxed separately, but rather are subsumed by the cost method. No allowance is made for dividends received in the opening value — ostensibly for the reason that the value of the shares should increase by more than five per cent in the long run. Therefore it is inappropriate to reduce the value by dividends received. However, withholding tax credits attached to dividends can be claimed against the tax on this FIF income;

(f) The quick sales rules apply to the cost method as with the FDR method;

(g) The cost method applies on an interest by interest basis, rather than the pooled approach as used in the FDR rules; and

(h) No foreign investment fund losses can be produced under the cost method.
(2) **Cost method formula [s EX 56(1)]**

The formula to be applied when using the cost method is:

\[
0.05 \times \text{opening value} + \text{quick sale adjustment}
\]

Opening value takes its meaning from s EX 56(3) and is central to the operation of the cost method. The opening value is adjusted if a person increases or decreases the size of their interest during the year.

“Opening value” is:

(a) Zero: if the year is the year that the interest is acquired;
(b) The net asset value of the FIF interest: if (a) does not apply and the amount is shown as the net asset value of the FIF interest in publicly available audited accounts if the FIF also has publicly available audited accounts; or
(c) The cost of the interest: if (a) and (b) do not apply, and the person acquired the interest in the 2005-2006 or 2006-2007 income years; or
(d) An independent valuation: if (a), (b) and (c) do not apply, and
   (i) The interest was not an attributing FIF interest in the previous year; or
   (ii) The person has used the cost method for at least the previous four income years prior to the current year;
(e) Opening value used for the immediately previous year + the previous year’s FIF income: if (a), (b), (c), and (d) do not apply, and the attributing FIF interest is the same as the person’s attributing FIF interest for the previous year. This is the opening value that will be applied when the interest neither increases nor decreases. In the absence in changes in shareholding in the FIF, this is likely to be the principal method used;
(f) Opening value used for the immediately previous year + the previous year’s FIF income + (increase × average value): if (a), (b), (c), and (d) do not apply, and the amount of the person’s interest at the beginning of the current income year is more than the person’s attributing FIF interest for the preceding year. This is the opening value that will be applied when the size of the interest has increased over that of the immediately preceding year. The formula increases the cost base of the FIF interest accordingly;
(g) Amount of the attributing FIF interest at the beginning of the current year / amount of attributing interest for the preceding year × (opening value used for the immediately previous year + the previous year’s FIF income): if (a), (b), (c), and (d) do not apply, and the amount of the person’s interest at the beginning of the current income year is less than the person’s attributing FIF interest for the preceding year. This is the opening value that will be applied when the size of the interest has decreased over that of the immediately preceding year. The formula decreases the size of the FIF interest accordingly. Presumably because the method is based on cost, the actual sales value of the interest is not used to reduce the cost. Instead the formula applies a ratio of the current year holding to the previous year’s shareholding, and reduces the previous year’s holding accordingly. If the person thought this did not correctly reflect the remaining value of their FIF interest they may be able to use the revaluation basis in s EX 56(3)(b) if they have used the cost method for four or more years.

**Example 1 (Standard case):**

Paul is an expatriate Australian and holds a less than 10 per cent interest of 13,000 shares in a family holding company resident in Australia that is used to hold the wider family’s interests in Asia Pacific. As the company is not listed on an approved index of the Australian Stock Exchange (ASX) (that is the ASX All Ordinaries, ASX 50 Leaders and ASX 200) the interest in the company is an interest in a FIF. When the new rules apply from 1 April 2007, Paul opts to use the cost method and obtains an independent valuation of his interest, which is $65,000. This is the opening value. Paul’s FIF income for the 2007-2008 year will be $3,250. For the 2008-2009 year Paul’s FIF opening value will be the preceding year’s opening value increased by the FIF income of $3,250, which is $68,250. His FIF income for 2008-2009 is then $3,412.50. Assuming Paul’s FIF interest does not change, his FIF income calculation under the cost method will continue on the same basis.
Example 2 (Interest increase):
During the 2009-2010 income year Paul acquires an additional 1,000 shares at a cost of $5.50. Because Paul did not hold these shares on 1 April 2009, they do not affect his 2009-2010 FIF income calculation. For the 2009-2010 income year, Paul uses the standard formula. His income is: (0.05 × $71,662.50) $3,583.12. However, for the 2010-2011 year, as the interest held at 1 April 2010 is larger than the interest held as at 1 April 2009, Paul has to adjust his opening value. The formula required for this purpose [s EX 56(3)(d) and (5)] is:

opening value used for the immediately previous year + the previous year’s FIF income + (change × average value)

For the 2010-2011 income year the opening value is:
$71,662.50 + $3,583.12 + (1000 × $5.50) = $80,745.62

The FIF income for the 2010-2011 income year is:
0.05 × $80,745.62 = $4,037.28

Example 3 (Interest decrease):
During the 2011-2012 income year Paul disposes of 2000 shares. Paul’s income for the 2011-2012 income year is calculated under the standard formula. His income is based on the previous year’s opening value increased by the five per cent FIF income. His income is therefore 0.05 × ($80,745.62 + $4,037.28) $84,782.90 = $4,239.14. However, as his opening FIF interest for the next year is lower than the preceding year, he is required to adjust the opening value. The formula required for this purpose [s EX 56(3)(e) and (6)] is:

amount of the attributing FIF interest at the beginning of the current year / amount of attributing interest for the preceding year × (opening value used for the immediately previous year + the previous year’s FIF income)

For the 2012-2013 income year the opening value is:
12,000/14,000 × ($84,782.90 + $4,239.14) = $76,304.60.

The FIF income for the 2012-2013 income year is:
0.05 × $76,304.60 = $3,815.23.

Example 4 (Revaluation):
Paul is concerned that the value of his FIF interest in their family company has decreased due to some downward movements in the value of the FIF’s assets. Paul has used the cost method for four or more years before the 2013-2014 income year, and is entitled to have his interest revalued under paragraph (d)(ii) of the definition of “opening value” (above). The interest is revalued by an independent valuation to $68,500. The FIF income for the 2013-2014 year is:
0.05 × $68,500 = $3,425

(3) Cost method and quick sales
Shares that are purchased after the start of the income year and sold before the end of are subject to a quick sale adjustment. Consistent with the FDR method, these rules are designed to ensure taxpayers are unable to buy and sell FIF interests and escape tax under the FIF rules.

The quick sale rules in the cost method are similar to those used in the FDR method, except that the quick sale adjustment is not limited to the lower of five per cent of the average cost of the FIF interest or the actual gain made, as it is in the FDR rules. Rather the quick sale adjustment simply taxes the shares acquired and disposed in the same year at five per cent of their average cost. This is consistent with the liability that would have been imposed under the cost method had the shares been taxed using that method. The formula is:

peak holding differential × average cost

Using the average cost approach takes account of the situation when different parcels of shares are purchased during the year at different prices, and avoids the need to trace costs. The “average cost” is the total amount of expenditure that the person incurs in acquiring or increasing, during the relevant income year, the attributing interest in the FIF, divided by the total for the relevant income year of the increase in the interest for each acquisition or increase.

In determining the shares subject to the quick sales adjustment, the rules are based on those used in determining the peak holding adjustment in the FDR rules.
Example 5 (Cost method and quick sales):
Paul owns 13,000 shares in a FIF. During the year Paul purchased 200, 300 and 500 shares respectively at $5, $5.25 and $5.50 and subsequently sold 2,000 in the same year. The peak holding differential under s EX 56(17) is the lesser of 1,000 (being the difference between the largest number of shares held less shares at the beginning of the year: 14,000 – 13,000) and 2,000 (being the difference between the largest number of shares held less shares at the end of the year: 14,000 – 12,000). The first parcel of shares acquired of 200 was acquired at $5 per share, the second parcel of 300 at $5.25 per share and the third parcel of 500 at $5.50 per share. Thus, the average cost is: $5,325 / 1,000 = $5.32. Although the quick sale adjustment is incorporated into the principal cost method formula in s EX 56(1), the effect is: 0.05 × 1,000 × $5.32 = $266. If this is related back to example 1 above, the FIF income for the year would be:

\[
0.05 \times $65,000 + 266 = $6,086
\]

850.200 Share reorganisations

There are rules to deal with situations when an investor buys and sells shares during an income year (or valuation period for managed funds) and there is a share reorganisation (share split) between when the shares were purchased and when they were sold. The rules essentially adjust the numbers of shares and their values taken into account for the quick sales rules so the results correctly reflect the share numbers and values after the bonus issue or share split. The rules also apply when a person is using the cost method and acquires more shares in the FIF that are subsequently affected by a share split. Thus, they are likely to have a narrow application.

The term “share reorganisation” is defined in s YA 1 as “an action of the FIF that causes an increase or reduction, other than for consideration, of the attributing interests held by the person, including the person, who holds attributing interests in the FIF immediately before the action”. Inland Revenue refers to share splits in this context. Shares acquired under an options arrangement do not constitute a share reorganisation for the purposes of s EX 54 as consideration passes.

The overriding objective of the share reorganisation rules is to ensure that the FDR and cost method formulas are correctly applied to give the right result when a share reorganisation has occurred and the quick sales rules apply.

The figures adjusted for the share reorganisation are used in:
(a) The item “peak holding differential” as applied in calculating the quick sale adjustment for the FDR method;
(b) The item “average cost” used in calculating the quick sales amounts in the FDR and cost methods; and
(c) The item “increase” used in calculating the application of the cost formula when an interest has increased from one year to the next.

Example:
SuperInvestor fund values its units monthly. Each month it is required to apply the FDR rate to the market value of its portfolio of foreign shares. In one month the SuperInvestor fund acquires and disposes of some shares to take advantage of an opportunity to make a gain on shares regarded as under valued. The market value of the fund as at 1 June was $14 million. The fund had 100,000 shares in undervalued Foreign Company Ltd. During June it acquired an extra 40,000 shares in UVC Ltd at $5. UVC Ltd reorganises its shares with a 1:1 share split. Following the split, the fund disposed of 40,000 shares at $3.50. As a share reorganisation has occurred, the rules in ss EX 53(12)(b) and EX 53(13)(b) that define “peak holding differential” and “average cost” respectively, for the purposes of determining the peak holding adjustment, direct us to s EX 54 to define these amounts.

Under s EX 54(4) “peak holding differential” is now defined as the lesser of the following:
(a) The difference between the “equivalent shareholding” that is the greatest for the period and the equivalent shareholding for the beginning of the period; or
(b) The difference between the “equivalent shareholding” that is the greatest for the period and the equivalent shareholding for the end of the period.

Using the rule in s EX 54(3), the “equivalent shareholding” is an amount treated as corresponding to an amount equal to the attributing FIF interest that the person would hold at the end of the affected period if the...
person did not increase or reduce the FIF interest other than by way of a share reorganisation. Effectively, this is the FIF interest size adjusted for the share reorganisation. The greatest equivalent interest size is thus 280,000 shares. The equivalent interest size at the start and end of the affected period is 200,000 and 240,000 shares respectively.

Peak holding differential, as adjusted for the share reorganisation, is now 40,000 shares. The definition of “average cost” is taken from s EX 54(5) as the total of the expenditure that the person incurs in the affected period in acquiring or increasing the FIF interest divided by the total of the “equivalent acquired shareholding”. Under s EX 54(3)(b) the “equivalent acquired shareholding” is an amount treated as corresponding to the difference between the equivalent interest size for the time of the acquisition or increase (280,000) and the amount that would be the equivalent interest size (200,000) if the person were not to have acquired the interest. Average cost is thus: $200,000 / 80,000 = $2.50 per share.

The peak holding adjustment formula in s EX 53(10) (ie 0.05 × peak holding differential × average cost) now gives:

\[
5\% \times 40,000 \times 2.50 = 5,000
\]

The funds FDR income for June is:

\[
5\% \times 14,000,000 \times 30/365 + 5,000 = 62,534.25
\]

This income figure has not changed from that used in the example at 850.190, when no share reorganisation occurred. This is what you would expect as the overriding objective of the share reorganisation rules is to ensure the correct result arises despite the share reorganisation.

The rules in s EX 54 appear complicated at first sight. However, when the end result is understood, a commonsense application of the equivalent shareholding rules should ensure a sensible result that is consistent with the objectives of the share reorganisation rules.

850.205  **Deemed rate of return method** [s EX 55]

The deemed rate of return (DRR) method for calculating FIF income or loss involves applying a deemed rate of return to the book value of a person’s FIF interest. The method was designed for those cases when the investor has insufficient information about the FIF to use any of the three other calculation methods, as is likely in cases of interests in foreign life insurance policies and foreign superannuation schemes for example.

With the introduction of the FDR method, the use of the DRR method is now likely to be very limited. This is because, for interests in foreign companies it can only be used if the interest is 10 per cent or greater and when it is not practical to use CV or AP, or when the interest has a book value of less than $250,000. DRR may be used if a person cannot use FDR (for a less than 10 per cent interest) because the interest is regarded as debt under s EX 46(10) and the CV method cannot be used. Even when DRR can be used, given the relatively high rate of deemed income (see below for the rates), there will be a natural reluctance to use it if other methods, such as FDR or cost, can be used. The circumstances when the DRR method can be used are also discussed at 850.155.

If a person’s interest has not changed throughout the income year, the formula employed in the Act to calculate DRR FIF income is referred to as the standard formula [s EX 55(3)], and if the person’s interest has changed during the year, the person’s income is determined by totalling the amounts determined under the part-year formula [s EX 55(5)].

A person’s interest in a FIF is regarded as changing during an income year if the person:

(a) Acquires or increases their interest; or
(b) Disposes or reduces their interest (although annuity receipts are not regarded as a disposal).

The FIF income of a person using the DRR standard formula is:

\[
\text{opening book value} \times \text{deemed rate}
\]

Where:
“Opening book value” of the interest is the value at the end of the previous income year calculated under s EX 55(7); and

“Deemed rate” is the rate set by the Governor-General by Order in council for the relevant income year, (see below).

The FIF income of a person using the DRR part-year formula (when a person’s FIF interest changes) is:

\[ \text{(opening book value + costs)} \times \frac{\text{(deemed rate \times days)}}{365} \]

Where:

“Opening book value” is the book value (if any) of the interest at the end of the period before the part of the income year, calculated under s EX 55(7);

“Costs” is the total for the part of the income year of all expenditure (if any) that the person incurs in acquiring or increasing the interest. Cost also includes the income tax on the FIF income that the person is liable under the laws of a country or territory outside New Zealand, and which is paid by the person in the income year or part of the income year;

“Deemed rate” is the rate set by the Governor-General by Order in council for the relevant income year; and

“Days” is the number of days in the part of the income year, and for this purpose, an acquisition or increase is treated as occurring at then start of a day and a disposal or reduction is treated as occurring at the end of a day.

In relation to the part-year formula, the formula requires a deemed rate of return calculation to be made each time there is an acquisition or disposal of an interest or a part of an interest (eg for an interest in a foreign superannuation scheme a separate calculation will be required in respect of each contribution). The part-year calculation will be based on the previous part-year’s closing book value.

For interests in foreign superannuation schemes and life insurance policies, the part year calculations can be particularly onerous. If monthly contributions were made, 12 calculations would be required. In this regard Inland Revenue allow a simplified calculation method as per Inland Revenue’s Technical Rulings Manual 39.8.4.3 — which although a little out of date, has not been withdrawn.

In order to simplify the calculation of such income under this method, the Department will allow taxpayers to calculate FIF income using a single calculation, based upon the book value of their interest at the mid point of their income year (ie when half of the contributions for the year have been made).

**Example (based on that in the Inland Revenue Technical ruling):**

A person first becomes liable to the FIF rules and is deemed to acquire the FIF interest on 1 April 2007 at $40,000. The person makes contributions of $1,000 each month. For the 2008 year the FIF income is based on the deemed acquisition cost of $46,000. FIF income = $46,000 \times 10.87\% = $5,000.

**Note:** For each subsequent year in respect of which the interest continues to be held, this value will take into account contributions covering the second half of the previous income year and those covering the first half of the current income year (ie a full years contributions). For example, the person’s income for the 2009 year under the policy (assuming the contributions remain unchanged) will be based on a 2008 closing book value of $63,000 (being $46,000 + $5,000 + $12,000).

Inland Revenue state the policy will only apply under the following circumstances:

(a) The person is a natural person;
(b) The FIF concerned is a foreign superannuation scheme or a foreign life insurance policy;
(c) Payments made by or on behalf of the person must be regular and equal throughout their entire income year;
(d) There must be no additional or lump sum payments made to the FIF at any time during the person’s income year;
(e) There must be no distributions made to or withdrawals made by the person from the FIF at any time during their income year.
Both the standard and part-year formulas rely on the closing book value formula in s EX 55(7), which is pivotal to the operation of the DRR method. In determining closing book value, the formula looks back to the opening value used for the previous income year and adds costs and FIF income determined for that year and subtracts any gains. The closing book value is:

\[(\text{opening book value} + \text{costs} + \text{deemed income} + \text{top-up amounts}) - \text{gains}\]

Where:

“Opening book value” is the book value (if any) of the interest at the end of the previous income year (or part year), (ie it could be nil if the interest was not owned in the previous income year or part year) calculated under s EX 55(7);

“Costs” is the total for the part of the income year of all expenditure (if any) that the person incurs in acquiring or increasing the interest. Cost also includes the income tax on the FIF income that the person is liable under the laws of a country or territory outside New Zealand, and which is paid by the person in the income year or part of the income year;

“Deemed income” is the FIF income from the interest for the income year or part year calculated under the standard formula or part-year formula in s EX 55(3) and (5) respectively;

“Top-up amounts” are amounts (essentially the difference between the actual gain and the deemed income from FIF interests to which the DRR method applies) that are top-up FIF income under ss EX 60 or EX 61; and

“Gains” is the total of all amounts that the person derives during the year or the part income year from holding or disposing of the interest, including any foreign tax credits allowed under s LJ 2.

Example:

A FIF interest was acquired on 1 April 2006 at a cost of $155,000. The book value for the purposes of calculating 2006-2007 DRR FIF income is: $0 + $155,000 + $0 + $0 = $155,000. The formula in s EX 55(7) includes the $155,000 as a cost. As the FIF interest was not owned during the previous income year the opening value is nil. DRR for the 2006-2007 year is: $155,000 × 10.27% = $15,918.50.

The opening book value for 2007-2008 is the prior year’s closing value, which is $155,000 (FIF cost) + $15918.50 (being the 2006-2007 FIF income) + $0 + $0 = $170,918.50. Thus, you will notice that in determining the prior year’s closing value, the formula looks back to that year’s (or part year’s) opening value and adjusts that to get to the closing value for the prior year. DRR for the 2007-2008 year is: $170,918.50 × 10.87% = $18,578.84. Closing book value for 2007-2008 is then: $170,918.50 + $18,578.84 = $189,497.34. DRR for the 2008-2009 year is based on: $189,497.34.

Note: The top-up amounts (particularly dividends) may well equal the gains: this prevents the book value of an interest falling below its original cost price unless a portion of the interest is disposed of.

The closing book value is zero if a person uses a calculation method different from the deemed rate of return method at the end of the income year: thus, no income is attributed under the DRR method. When a person changes from the DRR FIF method, the interest is deemed to be disposed of at the previous year’s closing book value under s EX 63(4)(c)(ii) if the person uses another cost method, or, if the person uses a look-through method, its market value under s EX 63(2).

Sections EX 55(10) and (13) contain adjustments to DRR income when a FIF interest is disposed of and, either inadequate income, or excess income has been returned in prior income years. Where a disposition occurs and the book value is less than nil following the disposition, FIF income is deemed to be derived equal to the amount that book value is less than nil. While this may seem counter-intuitive at first glance, recall that “gains” are subtracted in arriving at the closing tax book value. Closing tax book value is likely to be less than zero when the FIF interest (or part interest) is disposed of.

Similarly, if a person disposes of the whole of an attributing FIF interest (not just by way of receipt of an annuity) and the closing tax book value for the relevant income year is more than zero, the excess is subtracted when the FIF income is calculated under the DRR method for that year [s EX 55(13)]. The amount of the book value above zero is subtracted in the year of disposal as the person has over returned FIF income.
Note: Section EX 55(13) only applies when the whole FIF interest is disposed of. Thus, if a person was to dispose of half their interest for a loss, no adjustment is permitted even if a loss would arise if the entire interest was disposed of.

Example (book value less than nil):
The book value of an interest as at 31 March 2007 is $52,000. The deemed rate of return for the 2008 year is 10.87 per cent. The interest sold on 1 November 2007 for $57,500. Income for the part-year to 1 November 2007 = $52,000 + 10.87% × 215 / 365 = $3,329.50. Book value of interest as at 1 November 1994 [s EX 55(7)] = $52,000 + 0 + $3,329.50 + 0 - $57,500 = ($2,170.50).

Income for part-year ended 1 November 1994 [s EX 55(10)]:
= $3,329.50 + $2,170.50
= $5,500 (or $57,500 - $52,000)

Example (book value greater than nil):
The book value of an interest as at 31 March 2007 is $52,000. The deemed rate of return for the 2008 year is 10.87 per cent. The interest sold on 1 November 2007 for $47,500. Income for the part-year to 1 November 2007 = $52,000 × 10.87% × 215 / 365 = $3,329.50. Book value of interest as at 1 November 2007 [s EX 55(7)] = $52,000 + 0 + $3,329.50 + 0 - $47,500 = $7,829.50.

Income for part-year ended 1 November 2007 [s EX 55(13)]:
= $3,329.50 – $7,829.50
= ($4,500) (or $47,500 - $52,000)

However, if the aggregate book value of a person’s FIF interests is less than $250,000 at the end of the preceding income year, and any gain would not have been assessable if not for the FIF rules, no wash-up adjustment is undertaken for either overstated or understated income. Specifically, under ss EX 55(11) and (14), a disposal will not give rise to an adjustment under ss EX 55(10) and (13) to the DRR income if:

(a) The person is a natural person;
(b) The value of the FIF interest is $250,000 or less (being either the closing tax book value at the end of the income year if the person used the DRR to calculate FIF income for all attributing FIF interests in the previous year, or the market value in any other case);
(c) If the closing tax book value is less than zero, the deficit arises only because the person disposed of some or all of the interest; and
(d) The gain derived (or if a gain had been derived) from disposing of the interest, or part interest as the case may be, would not be assessable income under ordinary rules (ie were it not for the FIF rules the gain would not have been income).

This is essentially a compliance cost savings method for those natural persons who would, but for the FIF rules, have had no tax liability in respect of any gain made on the disposal of the interest and the value is below $250,000. Under s EX 55(12), a person can have further FIF income if a person calculating FIF income under the DRR method derives an amount from holding or disposing of the FIF interest that would, but for the FIF rules in s EX 59(2), be otherwise assessable income (ie dividends or revenue account property gains). This adjustment is calculated under s EX 60 and brings to income all gains from the FIF interest less total FIF income returned to date.

Example (holding gains):
A FIF interest was acquired on 1 April 2006 at a cost of $10,000. On 1 July 2006, the FIF paid a dividend of $2,000. The DRR was 10.27 per cent for the 2006-2007 income year. The 2006-2007 income from the fund under s EX 60 will be $973 ($2,000 less $1,027 assessed under s EX 56). If the dividend was received in the 2007-2008 income year instead, the DRR for that year was 10.87 per cent, there will be no income under s EX 60 because the income under s EX 56 ($1,027 for 2006-2007 and $1,198.63 for 2007-2008) would exceed the proceeds from the dividend.

Note: While this amount increases the closing tax book value formula in s EX 55(8)(d), it will also reduces the closing tax book value in s EX 55(8)(e) by the gains. However, additional income will arise under s EX 60.

Section EX 60 applies to both full and partial disposals. Its intention is to ensure the operation of the FIF regime does not result in a more advantageous tax treatment of gains received by taxpayers from a FIF interest.
International Tax Regime

than would have been the case if the FIF regime did not apply to them. As above, this may occur when a
dividend or other assessable income is received from the FIF that in aggregate exceed FIF income as
calculated under the DRR. Sections EX 55(12) and EX 60 operate to ensure the higher amount is assessable
in the case of DRR. Section EX 60 is discussed at 850.215.

Note: Rules apply to determine the “cost” of an interest acquired under a share split or non-taxable bonus
issue [s EX 68]. Rules also apply [s EX 57] to determine the New Zealand dollar amount of the FIF income
calculated under the DRR method. Essentially, the exchange rate is, at the choice of the person, either:

(a) The rate applying on the day an amount is incurred or derived; or
(b) For all such foreign currency amounts converted into New Zealand dollars on the average of the close
   of trading spot rate of exchange for the 15th day of each complete month falling in the income year.

The deemed rate of return is set by Government regulation each year and applies to all types of investments
for which a taxpayer uses the DRR method, including interests in superannuation schemes and life insurance
policies. The rates are as follows:

<table>
<thead>
<tr>
<th>Income Year</th>
<th>Deemed Rate of Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996-1997</td>
<td>12.04%</td>
</tr>
<tr>
<td>1997-1998</td>
<td>11.01%</td>
</tr>
<tr>
<td>1998-1999</td>
<td>9.82%</td>
</tr>
<tr>
<td>1999-2000</td>
<td>10.74%</td>
</tr>
<tr>
<td>2000-2001</td>
<td>10.29%</td>
</tr>
<tr>
<td>2001-2002</td>
<td>10.46%</td>
</tr>
<tr>
<td>2002-2003</td>
<td>9.90%</td>
</tr>
<tr>
<td>2003-2004</td>
<td>9.45%</td>
</tr>
<tr>
<td>2004-2005</td>
<td>10.17%</td>
</tr>
<tr>
<td>2005-2006</td>
<td>9.82%</td>
</tr>
<tr>
<td>2006-2007</td>
<td>10.27%</td>
</tr>
<tr>
<td>2007-2008</td>
<td>10.87%</td>
</tr>
<tr>
<td>2008-2009</td>
<td>9.18%</td>
</tr>
<tr>
<td>2009-2010</td>
<td>9.12%</td>
</tr>
</tbody>
</table>

**850.210 Additional FIF income or loss if CFC owns FIF** [ss CQ 5(3),
DN 6(3) and EX 58]

If a person has an income interest of 10 per cent or greater in a CFC for an accounting period, and the CFC
has an interest in a FIF, and because s EX 21(33) applies, the FIF income or loss is not taken into account in
calculating the branch equivalent income or loss of the CFC. Instead the FIF income or loss is calculated
directly to the persons with the income interests (of 10 per cent or more) in the CFC as though they owned
the interest in the FIF directly.

Because the owners of the income interests in the CFC are treated, in effect, as owning the interest in the
FIF, the FIF income is attributed back even if the CFC is resident in an unqualified grey-list country.

The person that has the FIF income or loss under these rules calculates the income similarly to that for the
CFC except that the income interest is multiplied by the FIF income or loss calculated by reference to the
CFC’s interest in the FIF, as per the formula:

\[
\text{income interest} \times \text{CFC's FIF income or loss}
\]

In calculating the FIF income or loss, s EX 58 requires the person with the interest in the CFC to:

(a) Choose the FIF calculation method; or
Otherwise apply the calculation rules in ss EX 44 to EX 61 (the central rules that determine FIF income or loss) as if the person held the interest directly; and

Apply the loss ring-fencing and jurisdictional ring-fencing rules in s DN 8 respectively as if the person held the interest directly.

If the underlying FIF is a life insurer, the FIF income or loss excludes the actuarially determined amount attributed to the policyholders or another company.

No FIF income arises under this section if s EX 31 applies [see 850.70 and 850.75].

**850.215 Top-up of FIF income** [s EX 60 and EX 61]

**(1)** *Deemed rate of return [s EX 60]*

The purpose of s EX 60 is to buttress the FIF regime to ensure the FIF rules do not result in a more advantageous tax treatment of gains received by taxpayers from a FIF interest than would have been the case if the FIF regime did not apply to them. This may occur for example if a dividend or other assessable income is received from the FIF that in aggregate exceed FIF income as calculated under the DRR.

Sections EX 55(12) and EX 60 thus operate to ensure all gains (both holding gains and gains on disposal) derived in respect of a FIF interest are assessable when the person accounts for FIF income under DRR. It does this through the formula in s EX 60(2). That formula states that a gain is FIF income if it results in a positive amount under the formula:

\[
\text{total income gains} - \text{total FIF income}
\]

Where:

“Total income gains” is the total of amounts, including the amount in question, derived by the person until that time from holding or disposing of the interest that would have been income if s EX 59(2) had not applied;

“Total FIF income” is the total FIF income, reduced by the total of FIF losses, derived by the person from the interest until, and including, the relevant period.

Essentially, this formula ensures that the results that would be obtained under DRR and CV are the same.

**Example (revenue account property gains):**

A FIF interest was acquired on 1 April 2006 at a cost of $155,000. DRR for the 2006-2007 year is $155,000 × 10.27% = $15,918.50. On 1 September 2007 the taxpayer sells 50 per cent of the FIF interest for $120,000. DRR for the 2007-2008 year based on two part years is:

(a) 1 April to 1 September: $170,918.50 × 10.87% × 154/365 = $7838.75.

(b) 2 September to 31 March: $170,918.50 + $7,838.75 = $178,757.25 × 10.87% × 211/365 = $11,232.67.

Top-up income calculated under s EX 60 is: total gains - total FIF income:

(a) Total gains: $120,000 - $77,500 = $42,500.

(b) Total FIF income: $15,918.50 + $7,838.75 = $23,757.25.

(c) Top-up income under s EX 60: $42,500 - $23,757.25 = $18,742.75.

Thus, DRR income for 2007-2008 is FIF income + top-up amount: $7,838.75 + $11,232.67 = $19,071.42 + $18,742.75 = $37,814.17.

Closing book value for 2007-2008 (which is the 2008-2009 opening value) is calculated as:

\[
\text{(opening book value + costs + FIF income + top-up amounts) - gains}
\]

\[
(\text{($178,757.25 + 0 + 11,232.67 + 7,510.08) - 120,000 = 77,500}}}
\]

Overall in respect of the 50 per cent interest sold, it cost $77,500 and realised $120,000 and thus made a gain of $42,500. The DRR and top-up income amounts to the end of the 2007-2008 year totalled $42,500. The opening balance for the 2008-2009 year is $77,500 — which is precisely 50 per cent of the original cost, which is the result that you would expect as that is the cost of the remaining FIF interest on which DRR should apply going forward.

Importantly in determining the figure that is “total income gains” for the purposes of s EX 60, the amount that goes in that figure in the case of disposals is the net gain (ie the disposal value less the cost, which in the
example is $42,500). In looking at the closing book value formula for 2007-2008, the FIF income for the first part-year calculation is not included (ie $7,838.75) as this was already incorporated in determining the closing tax book value for that part year.

(2) 1 April 1993 uplift interest [s EX 61]
Section EX 61 was necessary when the FIF rules were reintroduced with effect from 1 April 1993, and is now largely historical. The provision was designed to ensure taxpayers were unable to use the step up in market value to the FIF opening value for the purposes of the FIF rules to shelter an otherwise taxable distribution from a FIF.

Section EX 61 applies when a person:
(a) Has an attributing FIF interest;
(b) Held the interest as at 29 July 1992;
(c) Calculated FIF income using either the comparative value (CV) or deemed rate of return (DRR) method from 1 April 1993;
(d) Was treated as having reacquired the FIF interest at that time for its then market value under either s CG 23(1)(d) of the ITA 1994 or s EZ 7 of the ITA 2004; and
(e) Would, but for the FIF rules, have derived an amount from holding or disposing of the interest that would have been income if s EX 59(2) had not applied.

When these circumstances apply, FIF income (not losses) is deemed to arise under the formula:

\[
\text{Total income gains} - \text{Total FIF income}
\]

Where:

“Total income gains” is the total of amounts, including the amount in question, derived by the person until that time from holding or disposing of the interest that would have been income if s EX 59(2) had not applied;

“Total FIF income” is the total FIF income, reduced by the total of FIF losses, derived by the person from the interest until, and including, the relevant period.

The section applies to partial disposals as if they were separate interests [s EX 61(4)].

Example:
A person had an interest that was purchased for $60,000 in June 1990 and held the interest such that as at 1 April 1993 the opening FIF value was the market value of the interest, which was $100,000. The person disposed of the interest on 1 October 1993 for $102,000.

<table>
<thead>
<tr>
<th>Closing value</th>
<th>Nil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gains</td>
<td>$102,000</td>
</tr>
<tr>
<td>Opening value</td>
<td>Nil</td>
</tr>
<tr>
<td>Costs</td>
<td>$100,000</td>
</tr>
</tbody>
</table>

The FIF income for the period is:

\[
(\text{closing value + gains}) - (\text{opening value + costs})
\]

\[
(0 + $102,000) - (0 + $100,000)
\]

FIF income is $2000. However, if the retained earnings of the FIF of $40,000 been distributed prior to the application of the FIF rules, the income would have been $40,000. A similar analogy applies of the FIF interest was held on revenue account.

850.220 Timing of FIF income or loss [ss CQ 5(2), DN 6(2)]
A person’s FIF income or loss calculated under the AP or BE method is treated as being derived or incurred in the person’s income year in which the accounting period of the FIF ends. This rule is similar to that used in the CFC rules in s CQ 2(1)(b). For example, if a standard balance date of, say, 31 March 2009, and the person has an interest in a FIF with an accounting year ended 31 December, the FIF income determined under the AP or BE methods for the FIF's accounting period ended 31 December 2008 will be taxable in the person’s year ended 31 March 2009.
Note: Section CG 16(3) of the ITA 1994 contained a rule that stated that a person’s FIF income or loss calculated under the comparative value (CV) or deemed rate of return (DRR) method is treated as being derived or incurred in the income year for which it is calculated. This was dropped in the ITA 2004.

For methods other than AP or BE, the general rules apply (ie the relevant calculation rules in ss EX 51 to EX 56). Generally, these rules require FIF income to be measured over a person’s income year regardless of the balance date of the FIF. For example, in relation to FIF interests to which the FDR method is used, s EX 52 brings income to account by multiplying the market value of the FIF portfolio at the start of a person’s income by five per cent. If a person has a 30 June balance date, then FDR income would be calculated by reference to the market value on 1 July of the relevant year.

FIF income of a person who has ceased to be resident in New Zealand is treated as being derived while the person was resident: thus avoiding an argument that the income is derived evenly over the income year and apportioned over the period of residence and non-residence [s CQ 5(4)]. Also see the rules in s EX 64 when people become and cease being resident in New Zealand.

850.225 Entry and exit rules [s EX 64]

(1) Leaving New Zealand

If a person holding an attributing FIF interest uses the comparative value (CV), deemed rate of return (DRR), fair dividend rate (FDR) or cost method ceases to be resident in New Zealand, the person is treated as having sold the interest in the FIF for its market value immediately before their change of residence. The person is also treated as not holding the FIF interest when they become non-resident [s EX 64(2)(b)], thus ensuring only income derived in respect of the FIF interest while resident in New Zealand is subject to income tax in New Zealand.

(2) Coming to New Zealand

If upon becoming a resident of New Zealand or upon cessation of the 48-month period of transitional residence, a person holds an attributing FIF interest and for the period after the change in residence or status uses any one of the CV, DRR, FDR or cost methods in respect of the FIF, the person is treated as having bought the interest in the FIF for its market value immediately after their change of residence or status. In this situation, the notional acquisition at market value does apply for the purposes of the $50,000 investment threshold rule [ss CQ 5 and DN 6]. Rather, the cost of the shares will be their market value at the relevant time under s EX 64.

The person is also treated as not holding the FIF interest when they were not resident or a transitional resident. Thus, ensuring only income derived in respect of the FIF interest while resident in New Zealand is subject to income tax in New Zealand.

(3) Look-through calculation methods and change of residence

The reference to look-through methods is a reference to the accounting profits (AP) or branch equivalent (BE) methods of calculating FIF income or loss.

When a person ceases or becomes a resident of New Zealand, or ceases to be a transitional resident, and at the time holds an attributing FIF interest, and uses either the AP or BE method for the accounting period in which the change in residence (or status in the case of a transitional resident) occurs, the matter is dealt with through the income interest calculation rules in ss EX 16 and EX 17. These rules modify the measurement of the income interest in the foreign entity.

Under s EX 16, when a person becomes or ceases to be resident in New Zealand, the person’s income interest is deemed to be zero for that part of the accounting period during which the person is not resident in New Zealand. Section EX 17 then applies to calculate an income interest for the accounting period that is then used to determine the FIF income or loss. An example of this calculation and further explanation is provided at 850.40.
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Note: Section EX 16 specifically provides that s CQ 5(4) will still apply to deem any FIF income as being derived while the person is a New Zealand resident. This avoids any debate about the income being spread over the periods of residence and non-residence (or transitional residence) and apportioned further.

(4) Death of a person holding FIF interests

Note: Section EX 55 ITA 2004 deemed a disposal at market value when a person used a method other than the AP or BE methods. The Taxation (Base Maintenance and Miscellaneous Provisions) Act 2005 repealed s EX 55 ITA 2004 from the 2005-2006 income year, and introduced changes to the tax treatment of assets held on death, which may change the law in this regard. Subpart FC should be consulted if an issue arises for consideration.

850.230 Dispositions and acquisitions of FIF interests not at market value [ss GC 4 and EX 71]

If a person disposes of an attributing interest in a FIF and they used the comparative value (CV), deemed rate of return (DRR), fair dividend rate (FDR) or cost method prior to disposal and they received either no consideration, or a consideration that was below market value, the person is treated as disposing of the interest for an amount equal to market value at that time.

Similarly, if a person acquires an attributing interest in a FIF and they use the CV, DRR, FDR or cost method for the period after acquisition and the consideration is not equal to market value of the interest at that time, then the person is treated as having acquired the interest for its market value at that time.

850.235 Relationship between CV, DRR, FDR and cost methods with other provisions [s EX 59]

When a person calculates a FIF income or loss under the comparative value (CV) method, deemed rate of return (DRR) method, fair dividend rate (FDR) method (provided the FIF is not a grey-list FIF and the FIF interests falls to below 10 per cent during the year), or cost method:

(a) The person is treated as not having any income from the interest for the period other than FIF income, and in particular, any dividends derived and gains made on disposal of the interest are disregarded (essentially removing any potential for double taxation);

(b) The person is denied a deduction for any amount incurred in the period on acquiring some or all of the FIF interest, except to the extent allowed under the FIF rules (ensuring that deductions only arise under the FIF rules); and

(c) The FIF interest cannot be treated as trading stock.

The purpose of s EX 59 is to ensure that income that is counted as FIF income is not taxed under any other provisions, nor does it give rise to a double deduction or other advantage if a loss arose.

Section CD 36 also applies to prevent any amount distributed from a FIF (when the above FIF calculation methods are used) from being a dividend. Essentially the dividend is subsumed into the FIF income calculation.

The section puts some limits on FDR to cover those instances when, were the FDR method to be used, no FIF income arises and thus the ordinary rules should apply. The rule states that for the FDR method, s EX 59 only applies if:

(a) The FIF is a grey-list company; and

(b) The person holds a direct income interest of 10 per cent or more in the FIF at the beginning of the income year or period.

Essentially, s EX 59 is allowing the ordinary rules to apply (such that dividends will be treated as per normal and any capital/revenue gains on the disposal of the FIF interests are taxed accordingly) when a person has a FIF interest of 10 per cent or more in a FIF that is a company, and that interest falls to below 10 per cent during the income year. This is also discussed at 850.155 under the FDR method.
Example:
If a person has an interest in a grey-list FIF that is 12 per cent, and during the year the interest drops to seven per cent, the grey-list exemption will not apply for that year. The FDR method will only apply to the market value of the interest from the start of the next income year as the interest was not a less than 10 per cent interest at the start of the income year, as required by the FDR rules. Thus there may be a year when no FDR calculation is made, and thus, no case to include the interest within s EX 59 (ie the ordinary rules should apply to any dividend and gain or loss on disposal).

Section EX 59 does not apply to FIF interests subject to AP and the BE methods as under those methods dividends remain taxable and there is no reason to prohibit the ordinary rules applying to the acquisition and disposal of interests subject to those rules.

850.240 Change of calculation method [s EX 62]
The general rule is that once a person uses a particular FIF income or loss calculation method, they must use the same method for interests in the FIF for subsequent income years unless they are permitted to change. However, there are rules that do permit changes, although there are restrictions on changing methods in order to prevent persons from gaining a tax advantage by changing between methods when that would produce the lowest FIF income or highest FIF loss in a particular income year or accounting period.

Changes of FIF income or loss calculation methods fall into two categories: changes for practical reasons, such as when a particular method cannot be used, and when a person chooses to change. With the introduction of the FDR rules, there is an exception for changes between FDR and CV. For natural persons and trustees of family or charitable trusts, there is no limit on changes between these two methods. This is discussed further below.

(1) Change on practical grounds
A person may change if it is not practical to continue with the same method because:
(a) In the case of the accounting profits (AP) method, s EX 46(2) prevents its continued use, or it is impossible to obtain sufficient information to continue to use it;
(b) In the case of the branch equivalent (BE) method, it is impossible to obtain enough information to continue to use it;
(c) In the case of the comparative value (CV) method, it is impossible to obtain a market value at year end;
(d) In the case of the deemed rate of return (DRR) method, either the $250,000 threshold for its use [in s EX 46(4)(b)] is exceed or, if it was the default method because s EX 48 required DRR to be used as the default method, the need or reason for using it as the default method ceases to be applicable;
(e) In the case of the fair dividend rate (FDR) method, it is impossible to find out the start-of-year market value of the interest except by way of an independent valuation; or
(f) In the case of the cost method, if it was the default method under s EX 48 and it ceases to be the default method.

(2) Choosing to change
Other than changes between FDR and CV as discussed below, there are really very limited circumstances when a person can choose to change FIF income or loss calculation methods for reasons other than those set out above.
The two key situations are:
(a) If the person is a natural person and the value of the interest, at the end of the income year or accounting period before the year or period from the end of which the change takes effect, is less than $250,000; or
(b) The change is to and from the BE method.
In both situations it is necessary to give notice to the CIR that must:
(a) Give the reasons for the change;
(b) Comply with the CIR’s notice requirements;
(c) Be given before the end of the first income year or accounting period for which the change is to take effect, unless the CIR agrees to a retrospective notice; and
(d) In the case of a natural person with interests valued at less than $250,000, be given before the end of the year or period that is before the one that, at the end of which, the change takes effect.

Natural persons with interests valued at $250,000 or less can change FIF income or loss calculation methods to suit. Provided they meet the requirements of the particular method, they can change if they want to (eg they may anticipate a lower FIF income amount under another FIF method). However, the catch is in the CIR’s notice requirements in s EX 62(4)(d). These require a person to give a full one year’s notice before the change can be made. Section EX 62(4)(d) requires a notice of change to be given to the CIR “before the end of the period that is before the one from the end of which the change takes effect”. The year’s notice period is designed to stop people flip flopping between income or loss calculations methods to deliberately arbitrage between results obtained under the different methods. However, having given notice of the intent to change methods, there is no rule in s EX 62 that says the taxpayer has to change if the taxpayer decides not to.

In changing to and from the BE method, the following conditions apply:
(a) A person may change to the BE method if it is the first time for the change;
(b) A person may change from the BE method if they are changing back to a calculation method they used in respect of the FIF interest previously and this is the first time they have chosen to change;
(c) A person can elect to change more than once to or from the BE method, if they are unable to obtain sufficient information to calculate BE income or loss and the change is not undertaken principally to alter the persons income tax liability.

The rules around moving to and from the BE method are designed to be a little more flexible to recognise the reality of the BE rule requirements, but also because BE is regarded as the more accurate method in assessing a person’s FIF income.

(3) Changes between the fair dividend and comparative value methods
A person that is a natural person or the trustee of a complying trust that is a family trust or a trust (or other organisation) that is a charity (ie with income that is exempt under ss CW 41 or CW 42) may change to and from the FDR and CV methods, provided use of those methods is permitted.

This is to allow those people that have a return on their portfolio of less than five per cent to pay tax on that lower amount. The FDR method cannot be used for any FIF interests when the person uses the CV method for any interest that could have otherwise been subject to FDR. That is, once a person elects to use CV for a FIF interest, they have to use CV for all interests that they are eligible to use FDR for.

Note: When changing between methods the rules generally treat the interest as having been disposed of and reacquired at market value. However, there are exceptions [see 850.245].

850.245 Consequences of changing methods
Entering and exiting the FIF rules generally requires market value adjustments. A similar approach is taken when changing from one FIF calculation method to another.

(1) Changing from a cost-based method to a look-through method
In terms of changing FIF calculation methods, there is a general rule that applies when a person changes from (what the legislation refers to as) a cost-based calculation methods, which comprise the comparative value (CV), deemed rate of return (DRR), fair dividend rate (FDR) and cost methods, to (what the legislation refers to as) a look-through method, which comprise the accounting profits (AP) and branch equivalent (BE) methods.

The rule states that if a person is changing from a cost-based calculation method to a look-through calculation method or vice versa, then the person is treated as having:
(a) Disposed of the interest to an unrelated third party immediately before the start of the accounting period to which the new method applies;
(b) Reacquired it immediately after the start of the period; and
(c) Received for the disposal and paid for the reacquisition and amount equal to the FIF interest’s market value at the time.

(2) Changing from CV or FDR to DRR or Cost method

The same rule as the rule for moving from a cost-based method to a look-through method applies. That is the person holding the FIF interest is deemed to have:

(a) Disposed of the interest to an unrelated third party immediately before the start of the accounting period to which the new method applies;
(b) Reacquired it immediately after the start of the period; and
(c) Received for the disposal and paid for the reacquisition and amount equal to the FIF interest’s market value at the time.

(3) Changing from Cost or DRR to CV or FDR method

In this circumstance the rules differ from the standard market value approach. As with the rules above, there is still a deemed disposal and reacquisition on the last day of the previous income year and the start of the next income year respectively. However, the consideration deemed to be received and paid is not market value, but rather:

(a) If a person changes from the cost method: the value that would have been the person’s opening value under s EX 56 if the person had applied the cost method for that year. For examples that illustrate this value see 850.195; or
(b) If a person changes from the DRR method: the value is the closing book value under s EX 55 for the preceding income year [see 850.205].

(4) Changes between CV method and FDR method

When a person changes from the fair dividend rate method to the comparative value method, or vice versa, the general market value disposition rule applies. That is that the person holding the interest is deemed to have:

(a) Disposed of the interest to an unrelated third party immediately before the start of the accounting period to which the new method applies;
(b) Reacquired the interest at the start of the income year; and
(c) Received for the disposal and paid for the reacquisition and amount equal to the FIF interest’s market value at the time of disposal.

850.250 Changes in application of FIF exemptions

The general approach taken in the rules when an exemption ceases to apply or commences applying is to deem market value dispositions and acquisitions in the case of interests to which the comparative value (CV), deemed rate of return (DRR), fair dividend rate (FDR) or cost methods did or will apply, and a FIF income or loss apportionment approach if either the accounting profits (AP) or branch equivalent (BE) methods did or will apply.

The exemptions are contained in the following sections:

(a) CFC rules exemption [s EX 34];
(b) Ten per cent or greater interests in grey-list companies exemption [s EX 35];
(c) Venture capital company emigrating to grey-list country: 10-year exemption [s EX 36];
(d) Grey-list company owning New Zealand venture capital company: 10-year exemption [s EX 37];
(e) Shares in grey-list company acquired under venture capital agreement [s EX 37B];
(f) Exemption for employee share purchase scheme of grey-list company [s EX 38];
(g) Terminating exemption for grey-list company with numerous New Zealand shareholders [s EX 39];
(h) Foreign exchange control exemption [s EX 40];
(i) Income interest of non-resident or transitional resident [s EX 41];
(j) New Resident’s accrued superannuation entitlement exemption [s EX 42]; and
(k) Non-resident’s pension or annuity exemption [s EX 43].

The $50,000 de minimis exclusion is located in ss CQ 5(1)(d) or (e) and DN 6(1)(d) or (e) as part of the requirements to either take FIF income or losses respectively into account.

Note: The above list of exemptions omits the exemptions in ss EX 31 Exemption for ASX listed securities, EX 32 Exemption for Australian unit trusts with adequate turnover or distributions, EX 33 Exemption for Australian regulated superannuation savings and EZ 32 Terminating exemption for grey-list FIF investing in Australasian listed equities.

(1) Exemptions ceasing to apply

When a person has an interest in a foreign entity that would (but for one of the exemptions in ss EX 34 to EX 43), constitute an interest in a FIF, and the relevant exemption ceases to apply, or the person starts having FIF income or loss because the cost of their FIF interests increases above the $50,000 de minimis in ss CQ 5(1)(d) or (e) or DN 6(1)(d) or (e), then:

(a) If the person uses the CV, DRR, FDR or cost method to calculate FIF income or loss for the period following the change, the person is treated as having:
   (i) Disposed of the rights to an unrelated person immediately before the change;
   (ii) Reacquired them immediately after the change; and
   (iii) Received for the sale and paid for the repurchase an amount equal to their market value at that time.

(b) If the person uses the AP or BE method to calculate FIF income or loss for the period following the change, the FIF income or loss is reduced by subtracting the amount calculated in accordance with the formula:

\[
\text{FIF income or loss} \times \left(\frac{\text{days before change}}{\text{days in period}}\right)
\]

(2) Exemption starts to apply

When a person holds an interest in a FIF that ceases to be an attributing FIF interest because one of the exemptions in ss EX 34 to EX 43 (as listed above) starts to apply, or the person ceases having FIF income or loss because the cost of their FIF interests falls below the $50,000 de minimis in ss CQ 5(1)(d) or (e) or DN 6(1)(d) or (e), then:

(a) If the person uses the CV, DRR, FDR or cost method to calculate FIF income or loss for the period before the change, the person is treated as having:
   (i) Disposed of the interest to an unrelated person immediately before the change;
   (ii) Reacquired it immediately after the change; and
   (iii) Received for the sale and paid for the repurchase an amount equal to their market value at that time.

(b) If the person uses the AP or BE method to calculate FIF income or loss for that period, the FIF income or loss is reduced by subtracting the amount calculated in accordance with the formula:

\[
\text{FIF income or loss} \times \left(\frac{\text{days after change}}{\text{days in period}}\right)
\]
850.255 Foreign investment fund losses [ss DN 5, DN 6, DN 7, DN 8, IA 7(6), IQ 2 to IQ 4, IQ 6 to IQ 9]

Section DN 5 states that a FIF loss is allowed as a deduction. Prior to the introduction of the fair dividend rate for portfolio interests, from the income years commencing on or after 1 April 2007, all FIF losses were quarantined. For non-BE FIF losses, these could only be offset to the extent of FIF income returned in the same or prior income years. These losses can now be offset and carried forward in the same way as other losses. BE FIF losses, on the other hand, continue to be, quarantined jurisdictionally in the same way as CFC losses, as is discussed further below.

The FIF loss rules supplement the general permission and override the capital limitation. Section DN 6 sets out the circumstances when a person has a FIF loss in an income year. This is identical to the circumstances when a person has FIF income as set out in s CQ 5, and thus regard can be had to the discussion on when FIF income arises [see 850.140].

(1) Removal of ring-fencing rules for non-BE FIF losses

As mentioned above, the loss ring-fencing rules for FIF losses (other than FIF losses calculated under the branch equivalent method) no longer apply. If a person has an interest in a non-grey-list FIF that is above 10 per cent, (or the person uses CV for a share that is treated as equivalent to debt) any loss calculated under the CV method will be fully deductible without restriction.

If a taxpayer has a ring-fenced FIF loss from the 2006-2007 or an earlier income year that is still to be offset, it will be deductible in full in 2007-2008. The only FIF losses that continue to be subject to ring fencing are those arising under the branch equivalent method.

(2) CFC with FIF interest

As with the calculation of FIF income, when a person has an income interest of 10 per cent or more in a CFC, a person can also have a FIF loss in an income year if the CFC holds an interest in a FIF. This applies because FIF income of a CFC is attributed directly back to the persons with income interests of 10 per cent or more in a CFC under the rules for the calculation of branch equivalent income in ss EX 21(33) and EX 58.

(3) Branch equivalent FIF losses

FIF losses calculated under the branch equivalent (BE) method are treated very similarly to attributed CFC losses in that they are ring-fenced and only able to be offset against income arising from an income interest in a CFC or FIF resident in the same country as the CFC or FIF with the loss in the accounting period when the loss was incurred. In other words, BE FIF losses can generally only be offset against the CFC or FIF income arising in the same country and the BE FIF that gave rise to the loss.

Under s DN 8, if a person has a FIF loss calculated under the BE method, the deduction allowed for the loss in the income year is no more than:

(a) Any attributed CFC income of the person from a CFC resident in the same country as the FIF for the relevant accounting period of the CFC; and

(b) Any FIF income of the person for the income year that is calculated under the BE method from another FIF resident in the same country.

Once the attributed CFC income or FIF income has been reduced by the amount of a BE-FIF loss, that income may not be used again for loss offset purposes [s DN 8(2)]. Any amount not able to be deducted is a FIF net loss able to be used under s IQ 3.

(4) FIF losses carried forward

If a person has carried a BE FIF loss forward, under s IQ 3, the maximum amount that can be offset against the person’s net income must be no more than the total FIF income that they derive in the tax year from a FIF resident in the country in which the loss arose.

If a person has FIF losses to carry forward, but cannot offset the losses because the attributing FIF interest no longer gives rise to FIF income due to the value of the person’s FIF interests dropping below $50,000 at
all times in the income year (that is the rule in s CQ 5(1)(d) or (e) applies), the FIF loss may be offset against the person’s assessable income in respect of those attributing FIF interests that would, but for the $50,000 de minimis, give rise to FIF income in that income year. That is, the FIF losses can be offset against other income to the extent that there would have been FIF income, but for the exemption [s IQ 3(2)].

If a person is unable to offset any part of the maximum amount calculated because there is insufficient net income, the excess is treated as if it were a loss subject to the general loss rules in ss IA 2 to IA 4. This is due to the operation of s IA 7(6) that states that the general rules do not apply to FIF losses “except a surplus under s IQ 3”. Thus the excess can be carried forward as an ordinary loss or grouped as an ordinary loss.

(5) FIF losses grouped
Section IQ 5 sets out the circumstances when FIF losses can be grouped. Section IQ 5 allows FIF losses to be grouped when the companies are members of a wholly-owned group and the FIF losses (whether for that year or carried forward) have not been able to be grouped under s IC 5 — presumably because the general loss rules do not apply to FIF losses, except when there is a surplus loss carried forward and available under s IQ 3.

Section IQ 5(2) allows the FIF loss to be grouped. However, if the FIF loss is a BE FIF loss, s IQ 5(3) states that the net FIF loss can only be offset to another company that has attributed FIF income similarly calculated from an entity resident in the same country as that in which the loss arose.

If the other company has insufficient net income to fully absorb the BE FIF loss, then the surplus is treated as an ordinary loss of the other company, which can then be carried forward accordingly. The loss company is not able to carry forward the excess amount. Because the loss falls into the general loss rules, it no longer ring fenced to other FIF income from the same jurisdiction.

850.260 Determining the expenditure or cost of acquiring property
[s EX 68]
The following rules apply when it is necessary to determine the cost of a person’s attributing FIF interest for the purposes of the:
(a) $50,000 de minimis in ss CQ 5(1)(d) and (e) and DN 6(1)(d) and (e);
(b) Comparative value (CV) method;
(c) Deemed rate of return (DRR) method;
(d) Fair dividend rate (FDR) method;
(e) Cost method.

(1) FIFO cost flow identification
Other than when the LIFO rules are necessary in calculating the quick sales gains amounts in ss EX 52(12) and EX 53(16), when it is not possible to specifically identify the expenditure incurred on or cost of the FIF interest, as a result of multiple acquisitions or disposals, the taxpayer must use the “first in, first out” method of cost flow identification.

(2) Share splits or similar
If the FIF interest results from a share split, non-taxable bonus issue, or similar event, and the acquisition is not income of the person, the expenditure incurred on or the cost of the interest is a fair allocation of the cost of the original property that is split, based on the market values at the time of the split. In other words, the cost of the original FIF interest is deemed to encompass both the original interest and the new interest. For the income year of the split and subsequently the cost is then treated as follows:
(a) The cost allocated to the interest is no longer the cost of the original property that was split;
(b) The person is treated as having incurred the allocated amount on acquiring the interest when the original property was acquired; and
(c) The person is treated as not incurring any other cost on the interest merely because the original property ceases to exist.
(3) **Non-monetary cost**
If the expenditure or cost incurred by the taxpayer is in kind rather than in money, the amount of expenditure or cost is the market value of that in-kind expenditure or cost. The market value is measured at the time the expenditure or cost is incurred.

(4) **Exclusion of term life premiums**
If the FIF interest is an entitlement to a benefit under a foreign life insurance policy, the expenditure or cost incurred excludes any premiums paid in prior years to the extent that the premiums relate only to term life insurance attributable to those earlier years and do not result in an increase in the surrender value.

(5) **Exclusion of holding costs**
The expenditure or cost of acquiring an interest in a FIF excludes any expenditure under the financial arrangement rules or interest incurred on money borrowed to acquire the property, or any other holding costs incurred after acquisition. These costs could be claimed outside the FIF rules if the relevant nexus is met.

(6) **FIF interests acquired before 1 January 2000**
Sections EX 68(10) and (11) contain the rules that allows interests acquired before 1 January 2000 to be valued at half their market value at 1 April 2007 for the purposes of determining whether the person has FIF interests costing in excess of $50,000 [see 850.150].

(7) **Cost of inherited shares**
A common question that arises is how inherited shares are treated for the purposes of the $50,000 cost threshold rule. There is no specific statutory rule dealing with this issue and no one easy answer. However, there are some statutory rules in the ITA 2007 that may apply (see below). In the absence of a statutory rule applying, case law would suggest that there is no cost. This is most likely to arise in the case of former grey-list shares (discussed below). Generally, if the inherited FIF interest was a taxable FIF interest to the deceased, then the statutory provisions will provide the answer — but if not, case law will need to be relied upon.

The four main statutory rules to consider are:

(a) For FIF interests acquired from 1 October 2005, the death and asset transfer rules in subpart FC may apply to deem the FIF interest to be transferred from the deceased to the surviving spouse or close relative at either market value or existing tax book value, depending on whether roll-over relief is applicable [ss FC 1, FC 2, FC 3 and FC 4]. The rules in ss FC 1 to FC 4 only apply when the interest is an attributing FIF interest [s FC 1(2) definition of “tax base property”, see 1420.197]. For example, this rule may not assist if the shares are covered by an exemption. This is because they would not be attributing FIF interests at the time of inheritance. Interestingly, s EX 55 (which was repealed when subpart FC was enacted), deemed a FIF interest to be disposed of and reacquired on the date of becoming a New Zealand resident or on the expiry of the 48 month transitional resident rule.

(b) For shares invested in FIFs that were or are subject to the FIF rules, ss EX 71 and GC 4 could apply to deem an acquisition at market value, if the consideration provided for the shares was not equal to their market value at the time of acquisition [see 850.230]. Sections EX 71 and GC 4 only apply to taxable FIF interests. This rule will not apply if at the time of inheritance the FIF interest was not subject to tax under the FIF rules (eg if the deceased benefited from the grey-list exemption in respect of the FIF interest concerned). The former grey-list countries were Australia, Canada, Germany, Japan, Norway, Spain, UK and USA. The rules in ss EX 71 and GC 4 apply from the commencement of the FIF rules (ie from 1 April 1993).

(c) If a person becomes a New Zealand resident or ceases to be a transitional resident, s EX 64 deems the person’s FIF interests to be disposed of and reacquired at the relevant time for market value [see 850.225]. For example, if a person owned shares that had been inherited and later moved permanently to New Zealand, the shares would be deemed to be disposed of and reacquired on the date of becoming a New Zealand resident or on the expiry of the 48 month transitional resident rule. The rule in s EX 68(7) may also be relevant (see above). Although it was not designed to target
Inheritance, it could be relevant if FIF interests were left to someone in a will, because of some act or other value provided by the transferee to the deceased.

(d) For shares that are not FIF interests, s EX 67 may deem the share disposal and acquisition at market value (e.g., a similar approach to the former grey-list shares). For example, a person who holds their offshore shares on revenue account before those shares enter the FIF rules, or who lends their shares under the share lending rules at the time the person becomes subject to the FIF rules. Section EX 67 does not apply to interests of $50,000 or less [s CQ 5(1B), see 850.150]. For example, inherited shares worth $50,000 or less.

If the above rules do not apply, consideration of the common law will be necessary, as s EX 68 is not a code that covers all eventualities and the term “cost” is not generally defined for income tax purposes. The most likely scenario when recourse to case law will be required is when the inherited FIF interest was not a taxable FIF interest in the hands of the deceased. A common scenario would be in the case of an inheritance of former grey-list shares. In the cases that have gone before the Courts on this issue, the CIR has consistently argued that assets that are inherited either have no cost or the cost is nil.

In Halliwell v Commissioner of Inland Revenue (1991) 13 NZTC 8,197 (HC) the taxpayer inherited land that was considered by the CIR to be subject to the land tax rules and subject to tax on sale. One of the issues considered by the Court was the cost of the inherited land to be deducted from the sale proceeds. The Court held that the value of the land at the time of inheritance was to be deducted from the sale proceeds otherwise the capital itself would be taxed, not merely the profit on sale. Savage J stated (at 8,202):

“In my view, to arrive at the profit or gain that a person derives from a sale of property one must start with the cost or value of the property at the time the person acquired it and deduct that figure from the amount received on the sale. Obviously, if the person bought the property then the purchase price fixes the cost and thus the figure to be deducted; but if the person did not buy it but received it by way of gift or inheritance then it is the value of the property at the time of the acquisition by gift or inheritance that is to be deducted.”

For the purposes of the FIF rules this reasoning would suggest that the value of inherited shares at the date of inheritance should be used in establishing the cost of shares that are FIF interests. However, Halliwell was a case when it was necessary to measure the profit or gain on sale, not whether there was a “cost”, so is unlikely to be determinative in this context.

The other type of case in which the CIR has argued inherited assets have no cost is GST input tax cases on inherited assets and whether inherited assets qualify for an input tax credit.

In TRA Case S66 (1996) 17 NZTC 7,412, Judge Barber was asked to consider whether the transfer into a trading partnership of land that had been inherited gave rise to an input tax adjustment. The taxpayer claimed a credit on the basis of the market value of the property at the time of transfer. The Commissioner argued that as the property was inherited, the cost was nil. Judge Barber concluded that the taxpayer did not acquire or inherit the farm for a “nil cost”, as the Commissioner contended, rather he acquired it at no cost. As there was no cost, the market value option was the only one available to determine the value of the supply. The taxpayer won the case on a technicality, but for the issue at hand Judge Barber did find that there was no cost.

In Wilke v Commissioner of Inland Revenue (1998) 18 NZTC 13,923 (HC) the objector inherited 144 hectares of farmland from her deceased husband. Before her husband’s death, the land was leased by her husband to the farming partnership of the objector and her husband. The farming partnership was registered for GST in October 1986. On 12 March 1995 the objector’s husband died and she inherited the land absolutely and commenced farming in her own name. Panckhurst J found that no input tax deduction is available on inherited land when there is no cost.

Based on the reasoning in the above cases, it would appear that the Courts are prepared to accept that inherited property has no cost. Accordingly, it could be argued that the cost of inherited shares are not counted when considering the $50,000 investment threshold rule. However, the statutory rules will always prevail over the
common law if applicable. Subpart FC in particular needs to be considered. However, the deeming provisions of the FIF rules cannot be overlooked.

Note: The Taxation (International Investment and Remedial Matters) Bill proposes a statutory deemed disposition and reacquisition of inherited FIF interests from date of enactment. This is discussed in Future Tax developments and readers with an interest in this change should familiarise themselves with the changes and there may be impacts on the way the FIF interest and associated dividends are taxed.

850.265 Entities emigrating to or from New Zealand [ss EX 66, EX 66B]

Section EX 66 applies when a person holds rights that become an attributing FIF interest because the entity in which the interest is held emigrates from New Zealand.

In this circumstance the person is treated as having:

(a) Disposed of the interest immediately before the change to an unrelated person;
(b) Repurchased it immediately after the change; and
(c) Received for the sale and paid for the purchase an amount equal to the market value of the interest at the end of the business day on which the change occurred.

If the interest is one in respect of which the person is using the accounting profits (AP) or branch equivalent (BE) methods, s EX 24 does not apply and the FIF income or loss calculated for the full year is reduced under the following formula:

\[
\text{FIF income or loss} \times \left( \frac{\text{days before change}}{\text{days in period}} \right)
\]

Section EX 66B contains an identical set of rules that provide for a deemed disposal and reacquisition of an interest in a FIF if the rights in that FIF cease to be an attributing FIF interest because the entity ceases to be a FIF. The most common example of this would be if a foreign company or unit trust migrated to New Zealand. This happened with two ING funds, the Diversified Yield Fund and Regular Income Fund that migrated to New Zealand on 26 June 2009. This and some related issues were discussed in the Chartered Accountants Journal, vol 89, June 2010 at 38.

850.270 Change of FIF’s balance date

A person whose FIF income or loss is calculated under the accounting profits (AP) or branch equivalent (BE) method may elect, with the CIR’s approval, to base the calculation on a different accounting year of the FIF, referred to as the new accounting year.

The CIR may take any relevant factors into account, including:

(a) Whether the change is sought because ownership of the FIF has changed;
(b) Whether the change is sought because of taxation or other legal requirements in a country where the FIF is resident or does business; and
(c) Whether the change would postpone liability to income tax on FIF income.

In making the transition, if the transitional accounting period is more than one year and ends in a later income year of the person than the previous accounting period did, and as a consequence, FIF income was derived in that later income year (ie in effect skipping an income year), then the FIF income is divided by the number of days in the transitional period and the resulting amount is the FIF income derived on each day in the extended transitional accounting period. In considering this issue, regard should also be had to the rules as to when FIF income and losses arise under the BE and AP methods [see 850.220].

850.275 Conversion into New Zealand currency [s EX 57]

The rules for converting amounts from foreign currency into New Zealand currency have been standardised for the comparative value (CV), deemed rate of return DRR, fair dividend rate (FDR) and cost methods and are contained in s EX 57. The branch equivalent (BE) and accounting profits (AP) methods have their own conversion rules.

For the FDR, CV, DRR and cost methods there are two options for performing exchange rate conversions:
International Tax Regime

(a) Conversion using the exchange rate on the day for which market value is determined or on which each amount is derived or incurred; or

(b) Conversion at the average of the close of trading spot exchange rates for the 15th day of each month that falls in the year.

Having chosen a currency conversion method for an attributing interest in a FIF, a person must use the same method for that interest in subsequent income years. There is no provision to change methods [s EX 57(3)]. Further, s EX 57(3) requires the same currency conversion method to be used for all attributing interests that use the same FIF calculation method. For example, if a person chooses to use only the fair dividend rate method for their offshore portfolio share investments they must use the same currency conversion method — the actual (spot) exchange rates or an annual average rate — for all those investments. It will not be possible to change currency conversion methods from year to year for the same attributing interests.

For the AP method, the person must choose for all the calculations of the net after-tax accounting profits of the FIF to be in New Zealand dollars, or in the currency of the FIF’s accounts. If calculated in the currency of the FIF’s accounts, the result is then converted at the average of the close of trading spot exchange rates for the 15th day of each complete month that falls in the accounting period [s EX 49(8)]. The currency conversion method for BE FIFs is essentially the same as for AP FIFs [s EX 21].

Exchange rates acceptable to Inland Revenue for converting foreign currency amounts into New Zealand currency under the CFC and FIF rules are published six-monthly in the TIB. The rates for the first six months of each income year are published following the end of the September quarter, and the rates for the full 12 months are published at the end of the income year [see 760.25, 7000.170, Brookers Tax Rates Guide 10-900].

850.280 Deferral of FIF tax liability [TAA, s 183]

In certain circumstances some taxpayers are able to elect to defer their FIF income tax liability until they have received income from their FIF interests in cash (including proceeds of sale). This concession is subject to interest under Part 7 of the TAA being paid on the amount of deferred tax. The option is targeted at certain small investors and is designed to alleviate the cash flow difficulties such investors may experience from being taxed on an accrual basis.

The requirements of this deferral option are:

(a) It is limited to a natural person who has a FIF tax liability in an income year from FIF interests acquired before 2 July 1992 or before the person first became a resident;

(b) The person cannot realise the FIF interest, or should be subject to a significant economic loss if that happened;

(c) The person’s income for the income year (after deducting the aggregate of the total income tax payable by the person and the FIF income) must be less than $20,000;

(d) The person elects, by notice in writing to the CIR in such form as the CIR allows, to defer the payment of an amount of tax in the income year calculated by the formula:

\[
\text{person’s total income tax payable in the income year} \times \left( \frac{\text{person’s FIF income in the income year}}{\text{person’s total gross income in the income year}} \right)
\]

(e) The amount of tax deferred is subject to the interest regime;

(f) The amount of any interest imposed is itself deferred;

(g) Payment of the amount of tax (and interest) deferred is suspended until the earliest of when:

(i) The person disposes of the FIF interest; or

(ii) The FIF interest ceases to exist; or

(iii) The person is able to realise the FIF interest without significant economic loss.

(h) The amount of tax deferred is reduced by the amount of any cash distribution received by the person during the term of the investment.
850.285 Disclosure of foreign company or FIF interests [TAA, s 61]
Any person with an interest in a FIF or an income or control interest in a foreign company at any time during an income year is required to disclose that interest with their tax return for that year. The following information must be disclosed:

(a) The existence and nature of the interest; and
(b) Any other information about the interest required by the CIR.

Under s 61(2) of the TAA, the CIR is able to exempt persons or classes of persons from the requirement to disclose such interests.

With the changes to the FIF rules from 1 April 2007, the International Tax Disclosure Exemption (which is published annually) now reflects these changes. The first disclosure exemption that reflected the new rules was ITR19 [published in TIB vol 20:4 (May 2008) at 4]. The disclosure exemption for the 2010 year is ITR21. Reference should be made to the disclosure exemption notice to check what disclosure is or is not required, as there are penalties for non-disclosure.

If you use any of the following methods to calculate your FIF income or loss then the disclosure requirements are unchanged from prior years:

(a) Deemed rate of return (DRR);
(b) Accounting profits (AP); or
(c) Branch equivalent (BE).

However, the new tax rules have meant a change to or a development of the cost method, the fair dividend rate (FDR) and comparative value (CV) method, and the disclosure method, which are described below.

(1) Cost method
If you use the new cost method to calculate your FIF income, you will need to complete and file the Cost method foreign investment fund disclosure (IR449) form. Information to be disclosed on this form includes:

(a) Name of investment;
(b) Country of incorporation, organisation or registration (as appropriate);
(c) Opening value of the investment in New Zealand dollars; and
(d) Basis of opening value.

(2) FDR and CV methods
The disclosure requirements for the fair dividend rate (FDR) and comparative value (CV) methods vary depending on whether you are:

(a) An individual, trustee of a trust, closely-held company, other entity not covered below; or
(b) A widely-held company, widely-held superannuation fund, widely-held group investment fund, portfolio investment entity (PIE).

(3) Individuals and non-widely-held entities
If your FIF investment is in a country that we do not hold a double tax agreement (DTA) with as at 31 March 2008 and you use the new fair dividend rate or comparative value methods, then you will need to complete and file the relevant disclosure forms:

(a) IR447 for the fair dividend rate; or
(b) IR448 for the comparative value.

These forms require you to disclose:

(a) Name of security;
(b) Stock exchange code (if known);
(c) Country of incorporation or tax residence; and
(d) Opening market value at the beginning of your income year in New Zealand dollars.

(4) **Widely-held companies, widely-held superannuation funds, widely-held group investment funds, or PIEs**

For each calculation method used, separately disclose the end of year market value of your investments — split by the jurisdiction in which the attributing interest in the FIF is held or listed. Alternatively, a split by the currency in which the investment is held will be accepted as a reasonable proxy, as long as it is at least 90 to 95 per cent accurate for the underlying jurisdiction.

If your investments are denominated in euros you will need to split these into the underlying jurisdictions. The disclosure forms are:

(a) IR445 for the fair dividend rates; or
(b) IR446 for the comparative value.

850.290 **Transitional rules** [s EX 67]

(1) **Values at which offshore interests enter the new rules**

All investments that become subject for the first time to the new foreign investment fund rules, or rights for which the person is a share supplier in a returning share transfer [see 1340.90], enter the new rules at their market value on the start date of the new tax rules. For most individuals this will be 1 April 2007.

This entry into the new rules at market value is achieved under s EX 67(2) by a deemed disposition and reacquisition of the interests at their market value on the start date of the new FIF rules for the investor. This deemed disposition and reacquisition applies only for transitional purposes.

The rule does not set a new cost basis for the purposes of the $50,000 cost threshold for application of the FIF rules in ss CQ 5 and DN 6. The original cost basis applies for the purposes of the $50,000 threshold [ss CQ 5(1B) and DN 6(1B)].

A person who holds their investments on revenue account (ie a managed fund), and which becomes subject to the new FIF rules may have a resultant tax liability because of the deemed disposition and reacquisition under s EX 67(2). This liability can spread over three years beginning with the first year of application of the new FIF rules. At least one-third of this tax liability must be paid in the first year, half of the balance paid in the second year and the remaining balance paid in the third year [s EX 67(3)(a)].

A person who has a tax liability because of the deemed disposition and reacquisition under s EX 67 is not liable to pay any penalty or interest for an inaccuracy in an estimate (or shortfall in the payment), of provisional tax if the inaccuracy or shortfall arises because of the deemed disposal [s EX 67(3)(b)].
Chapter 860

KiwiSaver

860.05  Background

This chapter provides an outline of KiwiSaver and explains the obligations of employers, employees and Inland Revenue under the KiwiSaver scheme. Further information on KiwiSaver can be found on the

Staples Tax Guide 2012
KiwiSaver, which was first announced in the 2005 Budget, is part of a package of initiatives designed to increase the level of savings by individuals and support them in their retirement. KiwiSaver was introduced by the KiwiSaver Act 2006 (KA 2006), which received the Royal assent on 6 September 2006 and came into force on 1 December 2006 under the KiwiSaver Act Commencement Order 2006. The scheme came into operation on 1 July 2007.

The stated purpose of KiwiSaver is to “encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement. The Act aims to increase individuals’ well-being and financial independence, particularly in retirement, and to provide retirement benefits” [KA 2006, s 3]. KiwiSaver is intended to complement New Zealand Superannuation, enabling a person to enjoy more than a basic standard of living in their retirement.

Main features

The main features of KiwiSaver are:

(a) The scheme is not compulsory. Employees aged 18 or over, but less than 65, who start a new job from 1 July 2007 with a new employer are automatically enrolled into KiwiSaver (unless their employer is exempt — see below) but can opt out if they want to. Opting out can only be done within a timeframe of two to eight weeks after employment commences. A late opt-out is possible in certain circumstances. If an employee does not opt out during this timeframe, they are locked into KiwiSaver until age 65, although it is possible to take a contributions holiday of up to five years (renewable) and to withdraw funds to purchase a first home. See 860.20, 860.25.

(b) The scheme only applies to individuals who are citizens or residents of New Zealand and who normally live in New Zealand. See 860.15.

(c) The scheme only applies to employers who are resident in New Zealand or who operate from a fixed establishment in New Zealand. However, from 1 April 2008 employers who do not meet these requirements can choose to participate in KiwiSaver. See 860.15.

(d) Private domestic workers may be treated as both employers and employees for KiwiSaver purposes. See 860.65.

(e) Existing employees, and individuals who are not employed (eg the self-employed) can opt in to KiwiSaver at any time. Individuals who are not employees contract directly with a KiwiSaver scheme provider. Children under the age of 16 may only be enrolled in KiwiSaver by their legal guardians. Children aged 16 and 17 must co-sign with their legal guardians to enrol. Children aged 16 or 17 may opt in to KiwiSaver by contracting directly with the scheme provider if they are married, in a civil union or living with a de facto partner. See 860.35.

(f) Employees can choose which KiwiSaver scheme they wish to join. If a new employee does not choose a scheme, they will automatically be allocated to a default scheme by their employer or Inland Revenue. See 860.45, 860.50, 860.55.

(g) Special rules apply when a person is invalidly enrolled in the KiwiSaver scheme.

(h) Employers with an existing staff superannuation scheme as at 6 October 2009, approved by the Government Actuary, are exempt from automatically enrolling new employees into KiwiSaver. However, the employer’s employees may still opt in to KiwiSaver. See 860.30.

(i) Employers are required to make contribution deductions at the rate of two per cent or, if the employee so chooses, four per cent or eight per cent of the member’s gross salary or wages and forward the deductions to Inland Revenue. Inland Revenue forwards the contributions on to the appropriate KiwiSaver scheme. KiwiSaver contributions are not tax deductible. See 860.65, 860.70.

(j) Employers are required to make compulsory contributions for each employee who belongs to a KiwiSaver scheme or complying superannuation fund. The amount of the contribution is two per
cent of the employee’s gross salary or wages. The compulsory employer contributions must be paid in addition to gross salary or wages (ie employers cannot reduce salary or wages to offset the compulsory contribution). See 860.87.

(k) For the year ended 31 March 2009 only, to offset the cost of employer contributions (voluntary or compulsory) to employee KiwiSaver schemes and complying superannuation funds, employers were entitled to a tax credit equal to the amount of the employer contribution, up to a maximum of $20 per week per employee. This tax credit is not available after 31 March 2009. See 860.145.

(l) After the first 12 months of membership, members can take a contributions “holiday” of up to five years. At the end of the holiday period, a new holiday can be applied for. See 860.90.

(m) Members’ funds in KiwiSaver schemes are not government guaranteed. See 860.110.

(n) Savings are locked into the scheme until the age of eligibility for NZS (currently 65 years old). If an individual joins the scheme within five years of age of eligibility for NZS, savings are locked in for five years. However, funds may be released early if the member is making their first home purchase, is in significant financial hardship, has a serious illness or is emigrating permanently. See 860.95, 860.100.

(o) For members who applied before 1 June 2009, after 12 months of membership, up to half of a member’s contributions may be diverted to repayment of amounts secured by mortgage over their principal residence, if the scheme they belong to offers this facility. See 860.102.

(p) The Government makes a $1,000 start-up contribution to each new member’s account. A fee subsidy of $40 per year was payable before 1 April 2009. See 860.112.

(q) Members of KiwiSaver schemes and complying superannuation funds are entitled to an annual tax credit equal to the lesser of their total annual contributions and $521.43. For years ending before 1 July 2011, the maximum annual credit was $1,042.86. The tax credit is paid by the CIR to the member’s fund provider and credited to the member’s account. See 860.135.

(r) Qualifying members who have contributed to KiwiSaver for at least three years may receive a first home subsidy towards a deposit on their first home. The subsidy, which is administered by Housing New Zealand, is $1,000 for each year of contributing to KiwiSaver, up to a maximum of $5,000. For a couple saving together to buy a home, the combined subsidy could be up to $10,000. This subsidy is not covered by the KA 2006.

(s) KiwiSaver schemes are run by the private sector and must be registered by the Government Actuary. KiwiSaver schemes receive contributions from members, Inland Revenue and third parties (including PAYE intermediaries), and invest those contributions on behalf of members. Providers are able to offer a range of investment products within their KiwiSaver scheme, such as conservative, balanced and growth (with different risk profiles). See 860.115, 860.120.

(t) Existing registered superannuation schemes can convert to KiwiSaver schemes, continue operating independently of KiwiSaver, or establish a KiwiSaver scheme under an umbrella trust that also governs the registered superannuation scheme.

(u) Inland Revenue is the central administrator of KiwiSaver. It receives most of the contributions through the PAYE system. Inland Revenue has a number of other roles in relation to the KiwiSaver scheme, including providing information packs for employees, allocating new employees to default schemes, sending investment statements to employees, paying the $1,000 government contribution to new members’ accounts, administering contributions holidays and administering early withdrawals through financial hardship or serious illness.

(v) If an employer deducts a contribution from an employee but fails to pay the contribution to Inland Revenue, Inland Revenue will nevertheless pay the amount of the contribution to the employee’s KiwiSaver account and recover the arrears from the employer, in the same way as for unpaid PAYE deductions. See 860.70.
(w) Employer’s superannuation contribution tax (ESCT) is not payable on compulsory employer
collections.

(x) KiwiSaver members are able to transfer the balance in their KiwiSaver scheme to an Australian
complying superannuation fund if they emigrate permanently to Australia. Similarly, a person
emigrating to New Zealand from Australia can transfer their retirement savings from an Australian
complying superannuation fund to a KiwiSaver scheme. See 860.150.

860.15 Application [KA 2006, s 6]
The KiwiSaver scheme applies only to employees and other individuals who are New Zealand citizens or
are entitled (under the Immigration Act 2009) to be in New Zealand indefinitely, and are either:
(a) Living, or normally living in New Zealand; or
(b) State services employees serving outside New Zealand in jurisdictions where offers of KiwiSaver
scheme membership are lawful, and employed on New Zealand terms and conditions.

KiwiSaver only applies to employers who:
(a) Are resident in New Zealand [see 1250 RESIDENCE];
(b) Carry on business from a fixed establishment in New Zealand; or
(c) From 1 April 2008, do not meet the requirements of (a) or (b), but chose to participate in KiwiSaver.

860.20 Automatic enrolment [KA 2006, ss 10, 11, 12, 13, 14, 15, 22, 23, 23A]
Whenever an employee (who is aged 18 or over but less than the New Zealand superannuation qualification
age (currently 65), and is not a secondee) starts new employment with a new employer, the automatic
enrolment rules apply to the employee unless the employer is exempt [see 860.30]. The effect of automatic
enrolment is that all future salary and wages paid to the employee are subject to automatic deduction of
contributions, unless the employee opts out. This applies to salary or wages paid by the current employer
and by any subsequent new employer. In addition, the employee must become a member of a specific
KiwiSaver scheme. The automatic enrolment rules do not apply to an employee who is already a member of
a KiwiSaver scheme.

The employee must continue to be a member of a KiwiSaver scheme until the earlier of the following dates:
(a) The date an opt-out notice takes effect;
(b) The KiwiSaver end payment date (normally the age of entitlement to NZS);
(c) The date the provider terminates the employee’s membership because the employee has a zero
account balance; or
(d) The date the employee’s account balance is withdrawn or transferred to a foreign scheme, where the
employee emigrates permanently.

“New employment” does not include:
(a) Temporary employment;
(b) Employment where the employee remains on the same payroll (eg following promotion or the taking
up of a new position with the same employer);
(c) Employment with an employer who takes over an existing business in which the employee was
employed (eg as a result of company amalgamation or by the sale of the business as a going concern);
(d) Employment, at the end of a period of secondment, by the employer from whom the secondee
was seconded.

“Temporary employment” means employment as a casual agricultural worker, employment under a contract
of service for a period of 28 continuous days or less, or (from 1 April 2008) employment that is intermittent
or irregular.
A “secondee” is an employee whose employment is transferred temporarily from one employer to another,
and the employee is on that other employer’s payroll.
The automatic enrolment rules do not apply to:
(a) Persons who are employees only because they receive payments as working partners or working owners, parental leave payments or certain ACC payments;
(b) New employment as an election day worker or private domestic worker;
(c) Employees who are not required to have PAYE deducted from their salary or wages (eg where salary or wages is exempt income); or
(d) Employees who are absent from New Zealand in the service of the New Zealand Government and have PAYE deducted from their earnings because s YD 1(7) applies to them [see 1250.50].

An individual who starts new employment must advise their employer (or PAYE intermediary) whether or not they are already a member of a KiwiSaver scheme, and provide their name, address and tax file number. If they are already a KiwiSaver member, they must give their employer (or PAYE intermediary) either:
(a) A KiwiSaver deduction notice; or
(b) A copy of the notice from the CIR granting a contributions holiday.
If the employer (or PAYE intermediary) is satisfied that the automatic enrolment rules apply to a new employee, they must advise Inland Revenue of the employee’s name, address and tax file number with the next required employer monthly schedule.
A person who is in temporary employment and who is a member of a KiwiSaver scheme may give their temporary employer a KiwiSaver deduction notice.

860.25 Opting out [KA 2006, ss 16, 17, 18, 19, 20, 21]
All employees to whom the automatic enrolment rules apply may opt out of KiwiSaver, but they must do so between the 13th and 55th days after the date on which they started new employment, unless an extension of the opt-out period applies.

Example:
Jeff starts a new job on 8 October. None of the exclusions apply. Jeff is automatically enrolled in KiwiSaver from 8 October and his employer will begin to make deductions of contributions from Jeff’s first pay. Jeff received an information pack from his employer on 10 October. Jeff can opt out of KiwiSaver any time between 21 October and 2 December.

An employee opts out of KiwiSaver by giving an opt-out notice to the CIR or their employer. An opt-out notice must contain all the information required by the CIR. An opt-out takes effect on the date the notice is accepted by the CIR or received by the employer, as applicable. Opt-out cannot take place earlier than the 13th day after the date on which new employment started. An employer who receives an opt-out notice must advise the CIR by the due date for the next employer monthly schedule [see 1080.80, 1080.95].

The CIR may accept a late opt-out notice, if it is received by the CIR or the employer, no later than three months after the date the CIR receives the first contribution for that employee if one or more of the following applies:
(a) The employer failed to supply the employee with an information pack within seven days of employment commencing;
(b) The CIR failed to send an investment statement to the employee (where the CIR has provisionally allocated the employee to a default scheme);
(c) The employer did not supply an investment statement for the employer’s chosen KiwiSaver scheme (if applicable);
(d) Events beyond the control of the employee meant that the opt-out notice could not be given within the time limit;
(e) The employee was automatically enrolled when they should not have been (eg because they were under 18 or one of the exemptions applied).

If the opt-out notice is given to the CIR rather than the employer, the CIR must, as soon as practicable, advise the employer that the employee has opted out and that the employer should make no further deductions of
contributions. The way in which the CIR will exercise the discretion to accept or decline a late opt-out request is set out in SPS 07/04 [see TIB vol 19:6 (July 2007) at 48-52].

The effect of opting out is that:
(a) The employee does not become a member of a KiwiSaver scheme; and
(b) The employer must not make deductions from future salary or wage payments and refund to the employee any deductions already made and not paid to the CIR.

The CIR will refund to the employee any deductions held.

A PAYE intermediary is an employer for the purposes of the opt-out rules.

An opt-out notice only terminates automatic enrolment for the particular employment for which it was given. If the employee subsequently starts another new job, the automatic enrolment rules will apply and the employee will have to opt out again if he/she does not wish to join KiwiSaver.

860.30 Exempt employers [KA 2006, ss 24, 25, 26, 27, 28, 29, 30, 31, 32]

A person who starts new employment with an exempt employer is exempt from the automatic enrolment rules. However, this does not prevent an employee of an exempt employer from opting in to KiwiSaver [see 860.35]. In addition, an employee who is already a KiwiSaver member remains liable for automatic deduction of contributions from their salary or wages paid by an exempt employer.

An employer is eligible to be approved as an exempt employer if the Government Actuary is satisfied that the employer provides access to a superannuation scheme for its employees that complies with the following rules:

(a) Every person who (from 1 July 2007) becomes a permanent employee (see below) of the employer, and who is aged 18 or over but less than the New Zealand superannuation qualification age, is eligible on commencing employment to become a member of the scheme and to transfer to the scheme the employee’s accumulation from other superannuation schemes (if those schemes permit transfers out);
(b) The scheme is a registered superannuation scheme (a superannuation scheme registered under the Superannuation Schemes Act 1989) on or before 6 October 2009;
(c) The employer entered into the relevant participation agreement before 7 October 2009;
(d) The trust deed of the scheme permits a member who satisfies the scheme’s requirements for a withdrawal benefit to transfer their accumulation to another registered superannuation scheme or a KiwiSaver scheme (if those schemes permit transfers in); and
(e) The trust deed of the scheme requires that at least four per cent of the annual gross base salary or wages of each member is contributed to the scheme.

The four per cent minimum does not apply if an employee is temporarily relieved from contributions at that rate (eg because of financial hardship), or if the scheme is a defined benefit scheme that effectively accrues for the member the same benefits as if the contributions were at the rate of at least four per cent. The four per cent minimum may consist of employee contributions, employer contributions, or a combination of both.

A “permanent employee” is an employee who is not employed:
(a) As a casual agricultural worker; or
(b) Under a contract of service for a period of 28 continuous days or less;
and to whom the automatic enrolment rules would otherwise apply.

If contributions are a combination of employee and employer contributions, the four per cent minimum requirement is satisfied if the sum of the following amounts is at least four per cent of the annual gross base salary or wages:
(a) The minimum amount that the employee must contribute;
(b) The maximum amount that the employer would be required to contribute if the employee contributed the maximum amount.
An employer contribution does not count towards the four per cent minimum unless the employer is legally bound to make the contribution and the contribution vests completely in the employee within five years.

**Example:**

Company A provides access to a superannuation scheme for its employees. The trust deed provides that employees, if they decide to become members, must contribute at either one per cent or three percent of annual gross base salary. The employer is obliged to match the employee’s contributions (eg if the employee contributes one per cent, the company must contribute one per cent).

The scheme complies with the four per cent minimum rules as follows:

| Minimum amount employee member must contribute | 1% |
| Maximum amount employer must contribute if an employee member contributed the maximum amount | 3% |
| **Total** | **4%** |

From 7 October 2010, a person may apply to the Government Actuary for approval of an employer (the current employer) as an exempt employer if:

(a) An application (the old application) was received by the Government Actuary on or before 19 November 2009;

(b) As a result of the Government Actuary’s consideration of that old application under s 30 of the KA 2006 an employer was approved as an exempt employer; and

(c) Either that exempt employer is the current employer or the current employer is a succeeding employer for that exempt employer.

“Succeeding employer” means:

(a) An employer who succeeds the exempt employer due to a merger or acquisition of the exempt employer;

(b) Another employer who succeeds a succeeding employer for the exempt employer due to a merger or acquisition of that succeeding employer.

The application must include the following information:

(a) Information confirming that the scheme complies with the criteria for exemption (set out above);

(b) The name, address and tax file number of the employer;

(c) The names, addresses, tax file numbers and payroll arrangements of any other companies in the same group of companies as the employer, if the Government Actuary so requests.

The Government Actuary must process the application within 28 days and advise the employer as soon as possible thereafter whether it is approved or declined. If the application is approved, the Government Actuary must advise the employer of the effective date of exemption. The exemption may be revoked if the employer ceases to offer a superannuation scheme that meets the exemption criteria.

**860.35 Opting in** [KA 2006, ss 33, 34, 35, 36, 37]

A person may opt in to the KiwiSaver scheme if they are:

(a) Aged less than the New Zealand superannuation qualification age (currently 65);

(b) Not already a member of a KiwiSaver scheme; and

(c) Not subject to the automatic enrolment rules.

A person who is 18 years or more opts in to the KiwiSaver scheme by either or both:

(a) Contracting directly with a provider of a KiwiSaver scheme; and

(b) Giving their employer (if applicable) a KiwiSaver deduction notice.

An employee who opts in to the KiwiSaver scheme by giving their employer a deduction notice must provide the employer with their name, address and tax file number. If the employer is satisfied that the employee is eligible to opt in, the employer must provide the employee’s name, address and tax file number to the CIR by the due date for the next employer monthly schedule.
A PAYE intermediary is treated as an employer for the purposes of opting in.

The following opt-in rules apply to children aged under 18:

(a) Children who are under 16 may opt in only if all their guardians contract directly with the provider.
(b) Children who are 16 or 17 years old with a guardian may opt in if the child and one of their guardians jointly contract directly with the provider.
(c) Children who are 16 or 17 years old with no guardian (i.e., who are married, in a civil union or living with a de facto partner) may opt in by contracting directly with a provider.

In each case the child is treated as 18 years old for the purposes of the Minors’ Contracts Act 1969.

If a person who is less than 16 years old wishes to opt in, they can do so if all their guardians contract directly with a provider in the name of the person. If the person is 16 or 17 years old with a guardian they may opt in if the person and one of their guardians jointly contract directly with a provider in the name of that person.

In either of those circumstances if the provider accepts the person then that person will be treated as contracting directly with the provider and being 18 years for the purposes of the Minors’ Contracts Act 1969 and opting in under s 34(1)(a) of the KA 2006. A person who is 16 or 17 with no guardian may opt in if the person contracts directly with a provider. If the provider accepts the person in those circumstances then the person will be treated as being 18 years old for the purposes of the Minors’ Contracts Act 1969 and opting in under s 34(1)(a).

A further amendment has been made to the KiwiSaver rules to ensure that, if no PAYE deduction from the salary or wages of a child is required because they receive the child tax credit [s LC 3], no KiwiSaver deduction needs to be made either.

An employee who opts in is liable to deduction of contributions from salary or wages paid by the current and any future employers, and must become a member of a KiwiSaver scheme. If an employee has more than one employer at the same time, the employee can choose any one or more of the employers who must make KiwiSaver deductions.

**Example:**
Ashley, a 40-year-old New Zealand citizen, has been working with the same firm for 20 years and wants to join KiwiSaver. He advises his employer that he wants to opt in to KiwiSaver and provides his employer with a notice requiring deductions of contributions. Ashley is subject to deductions of contributions from his next payment of wages. Ashley gets a second job so he can save for an overseas holiday. He is also subject to deductions of contributions from his new job.

A person (whether or not an employee) who opts in cannot opt out and must continue to be a member of a KiwiSaver scheme until the earliest of:

(a) The KiwiSaver end payment date (normally the age of entitlement to NZS);
(b) The date the provider terminates the employee’s membership because the employee has a zero account balance; or
(c) The date the employee’s account balance is withdrawn or transferred to a foreign scheme, where the employee emigrates permanently.

An employee who opts in is liable for automatic deduction of contributions from salary or wages until the earlier of:

(a) The three dates shown above;
(b) The date on which a contributions holiday commences; or
(c) The date from which a tax deduction is not required under the PAYE rules.


Special rules apply when a person, who did not meet the criteria for membership at the time of joining, becomes a member of a KiwiSaver scheme. These rules apply when, because of a mistake:
A person who does not meet the requirements of s 6 of the KA 2006 [see 860.15] is enrolled in KiwiSaver;
(b) The automatic enrolment rules have been applied to a person who does not meet the requirements for automatic enrolment; or
(c) A person who does not meet the requirements for opting in has, in fact, opted in [KA 2006, s 59A].
The person who discovers the mistake is required to notify the CIR or the KiwiSaver scheme as soon as practicable.
The mistaken enrolment is treated as initially valid from the date the person was wrongly enrolled in the scheme (either by automatic enrolment or by opt-in) until the earlier of:
(a) Three months after the mistake is discovered by the KiwiSaver scheme provider;
(b) Three months after the mistake is notified to the provider by the CIR or another person; or
(c) The day the provider pays the member’s accumulation less the amount transferred from an Australian complying superannuation scheme, to the CIR [ KA 2006, s 59B].

(1) Validation confirmed [KA 2006, s 59C]
If, during the period of initial validation, the person meets the requirements of s 6 of the KA 2006, is less than 65 years old, and does not opt out, the person is treated as if they had met the requirements to join KiwiSaver from the date they were wrongly enrolled in the scheme. The CIR must notify the provider that validation has been confirmed, and the provider is not required to pay the member’s accumulation to the CIR.

Example:
After Kate completed her final year of school she started working at her local bakery over the summer before starting university. Kate’s employer automatically enrolled her in KiwiSaver. Two months later Kate became aware of the fact that she had been automatically enrolled. As she was only 17 (less than the age of eligibility for KiwiSaver membership) the enrolment was invalid. By the time Kate learned that she had been invalidly enrolled, she had already turned 18. This meant that her enrolment could be validated or Kate could choose to opt out. An opt-out has to be made within three months of when the CIR receives the first KiwiSaver contribution for Kate. Source: The new KiwiSaver legislation (Inland Revenue Policy Advice Division, Special Report, 21 December 2007) at 20.

(2) Validation not confirmed [KA 2006, s 59D]
If validation is not confirmed under s 59C by the end of the period of initial validation, the provider and the CIR have certain obligations. The provider must notify the CIR of the following information relating to the person:
(a) The amount of contributions received directly by the provider (not via the CIR), when they were received and (if available) who they were paid by;
(b) The amounts paid out by the provider under a mortgage diversion facility, and when they were paid; and
(c) The amounts paid to the person as permitted withdrawals, when they were paid out, the types of permitted withdrawals, and the amount of Crown contributions included in the permitted withdrawals.
The provider must also:
(a) Pay the amount of the member’s accumulation, less the amount transferred from an Australian complying superannuation scheme, to the CIR if the provider has not already done so; and
(b) Pay the amount transferred from an Australian complying superannuation scheme (the transferor scheme) or the amount of the member’s accumulation (whichever amount is smaller) to:
   (i) The transferor scheme;
   (ii) The Australian complying superannuation scheme chosen by the person; or
   (iii) An Australian complying superannuation scheme chosen by the CIR, if the person does not choose one and it is not appropriate to pay it to the transferor scheme.
The “member’s accumulation” [KA 2006, s 4(1)] is the net value of the total of:
(a) The member’s contributions;
(b) Any vested employer contributions;
(c) Any fee subsidies paid; or
(d) The Crown contribution.

The CIR must refund an amount equal to the total of:

(a) The contributions received by the provider (either directly or via the CIR), less the total of:
   (i) The amounts paid out by the provider under a mortgage diversion facility;
   (ii) The amounts paid out by the provider to the person as permitted withdrawals, excluding Crown contributions included in the withdrawals;
   (iii) Crown contributions;
   (iv) The amount that was transferred from an Australian complying superannuation scheme.

(b) Any contributions held by the CIR in the holding account and not passed on to the provider, net of interest;

(c) Interest payable under s 84 of the KA 2006 on the above contributions, from the day the CIR or the provider received the contributions until the day the CIR pays the refund.

The refund must be paid to the person, their employer, the Crown, or any other person that made a contribution, in proportion to the CIR’s best estimate of what they each contributed.

The members’ accumulated interest paid to the CIR by the provider and any contributions in the holding account must be paid by the CIR into the Crown Bank account.

860.40 Information packs [KA 2006, ss 40, 41, 42, 43]

The CIR is required to initially supply KiwiSaver information packs to employers and to any other person who requests them. The CIR is only required to supply the number of packs sufficient for the employer’s needs. Each information pack must contain:

(a) A description of the overall KiwiSaver scheme;
(b) A statement that membership of the scheme is at the member’s own risk;
(c) A summary of what could happen under the default allocation rules or if an employer has a chosen KiwiSaver scheme;
(d) A description of how to obtain information about KiwiSaver schemes;
(e) A statement that potential members should seek financial advice from an independent professional financial adviser (rather than an employer) if they want information on: their personal financial circumstances, deciding whether or not to opt in or opt out, choosing a KiwiSaver scheme or investment product of a KiwiSaver scheme, or the overall KiwiSaver scheme or its financial concepts;
(f) An opt-out notice form;
(g) An information privacy statement; and
(h) Any other prescribed information.

Employers are required to supply information packs to:

(a) All new employees who are subject to automatic enrolment, within seven days of employment starting;
(b) All employees who opt in, within seven days of the employee providing the deduction notice; and
(c) All employees who request one.

In addition, employers who have chosen a default KiwiSaver scheme must at the same time provide the above employees with:

(a) An investment statement for the scheme; and
KiwiSaver

(b) A statement that the employee will be allocated to the employer’s chosen KiwiSaver scheme if the employee does not choose their own.

860.45 **Choice of KiwiSaver scheme** [KA 2006, ss 44, 45]

People are allocated to KiwiSaver schemes in one of three ways:

(a) By the person choosing their own scheme;

(b) By the person being allocated to the employer’s chosen KiwiSaver scheme, if the person does not choose their own scheme and their employer has a chosen KiwiSaver scheme; or

(c) By the person being allocated to a default KiwiSaver scheme nominated by the CIR, in any other case.

A person may, at any time, choose a KiwiSaver scheme by contracting directly with the provider.

860.50 **Employer choice of KiwiSaver scheme** [KA 2006, ss 46, 47, 48]

Employers can choose a KiwiSaver scheme for their employees to belong to if the employee does not choose their own scheme. Membership of the chosen scheme must be open to all permanent employees.

A “permanent employee” is an employee who is not employed as a casual agricultural worker or under a contract of service for a period of 28 continuous days or less, and to whom the automatic enrolment rules apply, or would apply, but for the application of s 14 of the KA 2006 [see 860.20].

The employer must arrange access for its employees directly with the provider of the KiwiSaver scheme and give notice to the CIR of the name, address and tax file number of the employer and its chosen provider. The employer’s choice of KiwiSaver scheme is effective from the date the notice is accepted by the CIR, although the employer can specify a later date in the notice. The employer’s choice remains effective until:

(a) The employer notifies the CIR of an alternative choice of scheme;

(b) The employer notifies the CIR that the employer no longer has a chosen scheme; or

(c) The CIR notifies the employer that the employer’s choice has been revoked because it is not eligible.

An employee becomes a member of the employer’s chosen KiwiSaver scheme on the first day that the following conditions are met:

(a) The employer’s choice of KiwiSaver scheme is effective under s 47 of the KA 2006 (as explained above);

(b) The employee has not directly contracted with a provider of a KiwiSaver scheme to be a member of that scheme;

(c) The employee is automatically enrolled or opts in to KiwiSaver;

(d) More than three months have passed since the CIR received the first contributions for the employee; and

(e) There is no relevant dispute under ss 212 or 213 of the KA 2006.

The CIR is responsible for advising the provider of the employee’s details.

860.55 **Default KiwiSaver schemes** [KA 2006, ss 50, 51, 52]

An employee who is automatically enrolled or who opts in to the KiwiSaver scheme will be provisionally allocated to a default investment product of a default KiwiSaver scheme nominated by the CIR unless:

(a) The employee’s employer has a chosen KiwiSaver scheme;

(b) The employee has opted out; or

(c) The employee has contracted directly with a provider to become a member of a KiwiSaver scheme.

When a person is provisionally allocated to a default scheme, the CIR must notify the person of the name and address of the provider of the scheme, and the name of the default investment product of that scheme. The CIR must also provide the person with an investment statement relating to that product and advise the person what will happen if they do not choose their own KiwiSaver scheme.
Even though the person has been provisionally allocated to a default scheme, they still have the option of selecting their own KiwiSaver scheme provided they do so within three months after the CIR receives the first contribution for that person. Once the three months has expired, if the employee has not chosen their own scheme, the allocation to the default scheme becomes final (“complete”) and the CIR will advise the provider that the person has been allocated to the scheme. The allocation is legally binding on the member and the provider.

The default KiwiSaver schemes are:
(a) AMP Services (NZ) Ltd;
(b) ASB Group Investments Ltd;
(c) AXA New Zealand (National Mutual Corporate Superannuation Services Ltd);
(d) Mercer (NZ) Ltd;
(e) OnePath (NZ) Ltd; and
(f) Tower Employee Benefits Ltd.

860.60 Transfers between KiwiSaver schemes

A person may be a member of only one KiwiSaver scheme at a time. However, a person can have more than one account or investment product of a KiwiSaver scheme. A person may at any time transfer from one KiwiSaver scheme to another, or from a complying superannuation fund to a KiwiSaver scheme, by contracting directly with the provider of the new scheme. The provider of the new scheme must notify the CIR that the person has transferred to the new scheme, and notify the provider of the old scheme:
(a) That the person has ceased to be a member of the old scheme and the effective date of the transfer;
(b) The new scheme’s name and address; and
(c) That the provider of the old scheme must transfer the funds and information (as detailed below) to the new provider.

The provider of the new scheme must provide evidence to the provider of the old scheme that the member wishes to transfer. The provider of the old scheme must, within 35 days of receiving notice of transfer (or such longer period as is agreed):
(a) Transfer the member’s accumulation to the new scheme;
(b) Advise the member of the amount transferred; and
(c) Notify the provider of the new scheme:
   (i) Of the date on which the member first became a member of a KiwiSaver scheme (if the old scheme is a KiwiSaver scheme);
   (ii) Whether the member has made a withdrawal in order to purchase a first home;
   (iii) Of any contribution holiday in force;
   (iv) As to whether the $1,000 Crown contribution is included in the member’s accumulation transferred to the new scheme; and
   (v) Of any information that would be relevant to a provider of the new scheme when making a claim for KiwiSaver tax credits, including information about periods already claimed for.

A person may be required to transfer from one KiwiSaver scheme to another or from a complying superannuation fund to a KiwiSaver scheme involuntarily. For example, if an employee ceases to be eligible to be a member of an employer’s chosen scheme or because a KiwiSaver scheme is being wound up. The rules for allocating the person to a new scheme in these circumstances are set out in ss 57 to 59 of the KA 2006.

A “complying superannuation fund” means a superannuation fund that is approved as a complying superannuation fund by the Government Actuary under s 35 of the Superannuation Schemes Act 1989 [s YA 1].
860.65 **Requirement for employers to deduct contributions** [KA 2006, ss 60, 61, 62, 63, 63A]

An employer is required to deduct KiwiSaver contributions from the salary or wages of any employee to whom any one or more of the following apply:

(a) The employee commenced employment with the employer and the automatic enrolment rules apply;
(b) The employee has given the employer a KiwiSaver deduction notice;
(c) The CIR has given the employer a notice requiring the deduction of contributions from the employee’s salary or wages.

An employer is not required to make deductions from an employee’s salary or wages:

(a) If the employee opts out;
(b) For the duration of a contributions holiday; or
(c) If no tax deduction is required under the PAYE rules (eg when salary or wages are exempt). However, this exclusion does not apply to salary and wages paid for a private domestic worker.

The requirement to make deductions of contributions applies also to PAYE intermediaries [see 1090 PAYE INTERMEDIARIES]. References to the employer are to be read as if they were references to the PAYE intermediary.

For the purposes of making KiwiSaver deductions, a private domestic worker is treated as making payments of salary or wages to themselves in the capacity of employee. Consequently, the private domestic worker may be both employer and employee.

860.70 **Deduction of contributions from salary or wages** [KA 2006, ss 64, 65, 66, 67, 68, 69]

An employer who is required to make deductions of contributions from salary or wages, as explained in 860.65, must deduct from each payment of gross salary or wages an amount equal to the contribution rate.

The employer contribution must be an employer’s superannuation contribution as defined in s RD 65(1), and must vest completely in the employee immediately after the contribution is made.

(1) **Contribution rate**

The contribution rate from 1 April 2009 is:

(a) Two per cent of the employee’s gross salary or wages; or
(b) Four per cent of the employee’s gross salary or wages (if the employee so elects); or
(c) Eight per cent of the employee’s gross salary or wages (if the employee so elects).

The default contribution rate is two per cent. If an employee elects to join KiwiSaver or is automatically enrolled, but does not elect the four per cent or eight per cent rate, contributions are deducted by the employer at the two per cent rate.

An employee may change their contribution rate from their current rate to either of the other two rates by giving notice to their employer.

Where an employee changes their contribution rate, the new rate applies to the next payment of salary or wages calculated after the employer receives the notice. An employee cannot change their contribution rate more than once every three months, unless the employer agrees.

(2) **Accounting for deductions**

The PAYE rules apply to deductions of contributions as far as applicable. This means, among other things, that the deductions must be paid to the CIR along with tax deductions under the PAYE rules [see 1080 PAYE].
Money paid by a member to a provider for things other than KiwiSaver contributions (eg life insurance) does not count as a KiwiSaver contribution and cannot be paid via Inland Revenue. An employer is not required by the KiwiSaver Act 2006 to make deductions for such payments. If an employer makes a deduction of contributions but does not pay the deduction to the CIR by the due date for PAYE deductions, the amount of the deduction is treated as having been received by Inland Revenue on the 15th of the month in which the deduction was made. The amount is therefore forwarded by Inland Revenue to the provider(s) of the scheme even though it has not received that amount from the employer. Inland Revenue will then seek to recover the amount in arrears from the employer under the PAYE rules.

860.75  **KiwiSaver holding account**  [KA 2006, ss 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 81B, 82, 83, 113]

Deductions from salary or wages and other contributions paid to Inland Revenue under the KA 2006 must be held in the Inland Revenue KiwiSaver Holding Account (“holding account”) until they are paid to the provider of the relevant KiwiSaver scheme, or otherwise dealt with. Amounts entered in the holding account must be paid to the relevant KiwiSaver scheme as soon as practicable following receipt. However, contributions received by the CIR during the first three months of membership must be retained in the holding account until the end of that three-month period. The three month period commences on the earlier of the day the CIR receives the first contribution or the day the CIR is advised of the new membership. Those contributions must then be paid to the provider of the person’s KiwiSaver scheme as soon as practicable after the expiry of the three months. This allows for the fact that a person entering the KiwiSaver scheme has up to three months to choose a scheme.

Inland Revenue may hold contributions relating to a person in the holding account until the total amount meets a minimum threshold that Inland Revenue has agreed with the provider of the scheme. The amount is then paid to the provider. Inland Revenue can refund a contribution to a person in relation to whom a contribution was made, or from whose salary or wages it was deducted if:

(a) The person opts out and the contribution is in the possession of Inland Revenue;
(b) The contribution exceeds the amount required to be deducted and the contribution is in the possession of Inland Revenue; or
(c) The person has opted out and the contribution was not refunded to the person by the employer or paid to Inland Revenue.

If the CIR can not process an amount held in the holding account in the way set out above, or the amount is in excess of what the KiwiSaver Act 2006 or a Revenue Act requires to be in the holding account, then the CIR may refund the amount to a person that the CIR considers has the best claim to it.

The provider must refund to the CIR any amount that the CIR pays to the provider in excess of the amount required to be paid under the KiwiSaver scheme.

860.80 **Interest on contributions**  [KA 2006, ss 84, 85, 86, 87, 88, 89, 90, 91]

Interest is payable by Inland Revenue on contributions for the period from the day the contributions are received (or treated as received) by Inland Revenue until the day the contributions are paid to the provider or refunded. The rate of interest is:

\[
\text{CIR’s paying rate} \times (1 - \text{lowest tax rate})
\]

The “CIR’s paying rate” is the rate of interest set under the use-of-money interest rules [see 1110.290] on the day the contribution is received. The “lowest tax rate” is the basic rate of tax in sch 1, Part D, Table 2, row 7, column 3, expressed as a decimal. The interest rate calculated using the above formula is rounded to two decimal places.

**Example:**

Assuming the CIR’s paying rate at the time a contribution is received by the CIR is 2.18 per cent, the rate of interest payable on contributions would be 1.95 per cent calculated as follows for the 2011-2012 tax year (lowest tax rate is 10.5 per cent):

\[
2.18 \times (1 - 0.105)
\]
For the purpose of calculating interest:

(a) Contributions that are deducted from salary or wages are treated as received by the CIR on the 15th day of the month;

(b) Employer contributions are treated as received on the first day of the month in which the CIR receives them.

If the contributions that are paid to the provider of the person’s KiwiSaver scheme, the interest is paid at the same time as the contribution to which it relates. In the case of refunds of contributions, the interest is paid together with the refunded contribution.

Interest is not charged on money held in the holding account if the member notifies the CIR in writing that they do not wish to be paid interest.

**860.85 Other contributions** [KA 2006, ss 92, 92A, 93, 94, 95, 96, 97, 98, 99, 100, 101]

Employer contributions must be paid to Inland Revenue, and must be accompanied by a PAYE payment form. The contributions must be paid to Inland Revenue within the time limit for the payment of PAYE tax deductions, as if the contribution were an amount of tax. The employer must include details of employer contributions paid for each employee on the employer monthly schedule for the period. Failure to do so constitutes a short payment for the PAYE period. Private domestic workers are treated as employers when making payments of salary or wages to themselves in the capacity of employees.

If an employer intends to make voluntary contributions via Inland Revenue, the employer must advise both the provider of the KiwiSaver scheme and the employee, if the employer has a contractual obligation to the employee to pay those contributions.

A person other than an employer (including the member) can make a contribution to a person’s KiwiSaver scheme via Inland Revenue if the payment is accompanied by the member’s name, address and tax file number, and any other information Inland Revenue may require. If an employee opts out after an employer contribution has been paid to Inland Revenue, then Inland Revenue may refund the contribution to the employer.


(1) **Requirement to make compulsory employer contributions** [KA 2006, ss 101A-101C]

Employers are required to make compulsory employer contributions for employees who are:

(a) Paid salary or wages from which the employer is required to deduct employee contributions for a KiwiSaver scheme or complying superannuation fund;

(b) Aged 18 years or over;

(c) Not entitled to withdraw an amount from the scheme or fund on retirement; and

(d) Not a defined benefit scheme member.

A “complying superannuation fund” means a superannuation fund that is approved as a complying superannuation fund by the Government Actuary under s 35 of the Superannuation Schemes Act 1989 [s YA 1].

Compulsory employer contributions are payable in addition to the employee’s gross salary or wages. The parties to an employment contract are prohibited from contracting out of this rule. During the period from 13 December 2007 to 14 December 2008 (both dates inclusive) the parties to an employment agreement were able to agree contractual terms that disregarded this rule. However, bargaining for terms and conditions relating to compulsory contributions must be based on the duty of good faith.

Compulsory employer contributions made before 1 April 2012 are not subject to employer’s superannuation contribution tax (ESCT) [s RD 65(4)] See 1390.45.
(2) **Grace periods [KA 2006, s 101FB]**

An employer is not required to pay a compulsory employer contribution for a payment of gross salary or wages to an employee in a grace period if, for the whole of the grace period:

(a) One or both of the following apply:
   (i) The automatic enrolment rules apply to the employee;
   (ii) The employer does not receive a notice under ss 34(1) or 39 of the KA 2006 that the employee has opted in;

(b) The employer does not deduct any amount of contributions required to be deducted from an employee’s salary or wages; and

(c) The employer does not receive a notice under s 61 of the KA 2006 that requires the deduction of contributions for the employee.

The grace periods are:

(a) The period starting on the day the employee starts new employment and finishing on the earlier of the day that:
   (i) Is one year after the day the employee starts new employment;
   (ii) The employee ceases employment.

(b) The period starting on the day that is one year after the day the employee starts new employment and finishing on the earliest of the day that:
   (i) Is before the day on which the employer receives a notice under ss 34(1) or 39 of the KA 2006 that the employee has opted in;
   (ii) Is before the day on which the employer receives a notice under s 61 of the KA 2006 that requires the deduction of contributions for the employee;
   (iii) The employee ceases employment.

(3) **Amount of contribution [KA 2006, s 101D]**

The amount of compulsory employer contribution is the positive amount calculated using the formula:

\[
\text{payout of gross salary or wages} \times \text{CEC rate} - \text{other contributions} - \text{hybrid schemes amount}
\]

Where:

“Payment of gross salary or wages” is the amount of gross salary or wages from which the employer is required to deduct an amount for the employee’s KiwiSaver scheme or complying superannuation fund.

“CEC rate” is the applicable one of the following rates:

<table>
<thead>
<tr>
<th>Year during which the pay period falls</th>
<th>Percentage of gross salary or wages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year ending 31 March 2009</td>
<td>1%</td>
</tr>
<tr>
<td>Year ending 31 March 2010 and subsequent years</td>
<td>2%</td>
</tr>
</tbody>
</table>

According to Inland Revenue, the rate for a year applies only if the whole pay period is in the year specified. For example, if a pay period spans 1 April 2009, then the one per cent rate will apply. The two per cent rate will apply to the next pay period [see Inland Revenue Policy Advice Division Special Report, *The new KiwiSaver legislation* (21 December 2007) at 9.]

“Other contributions” means the total of:

(a) Voluntary employer contributions to a KiwiSaver scheme or a complying superannuation fund;

(b) Employer contributions to a registered superannuation scheme, registered before 17 May 2007, that meets certain criteria [KA 2006, s 101D(5)(b)];

(c) Employer contributions for an employee who is a member of Parliament, a judicial officer, constable, or a class of employee prescribed in regulations made under s 230A of the KA 2006.
“Hybrid schemes amount” is the amount (calculated using the formula below) of the contribution an employer makes to a registered superannuation scheme, where contributions are not paid each pay period, but rather the retirement benefits are calculated by adding to employee’s total contributions a percentage of those contributions. The amount of the contribution for the pay period is calculated as follows:

\[
\text{member’s contribution} \times \text{vesting percentage}
\]

Where:

“Member’s contribution” is the amount of the employee’s contribution for the pay period.

“Vesting percentage” is the percentage of the employee’s total contributions to be added to those contributions five years after the employee first became a member of the scheme [KA 2006, s 101D].

(4) **De minimis [KA 2006, s 101FC]**

An employer does not have to pay a compulsory employer contribution for a payment of gross salary or wages if, in respect of the payment, one of the following amounts is equal to or more than the relevant CEC rate in s 101D(4) of the KA 2006:

(a) The amount of the other contributions (as defined above) that meets the requirements of s 101D(5)(b) of the KA 2006 divided by the employee’s salary or wages;

(b) The hybrid schemes amount (as defined above) that meets the requirements of s 101D(6)-(8) of the KA 2006 divided by the employee’s salary or wages.

(5) **Allocation between schemes and funds [KA 2006, s 101E]**

If an employee belongs to both a KiwiSaver scheme and one or more complying superannuation funds, the compulsory employer contribution is first allocated to the KiwiSaver scheme, up to the maximum required to meet the employer’s compulsory contribution obligation, with any remaining amount being allocated on a pro rata basis between the complying superannuation funds. However, the employer and the employee may agree on a different basis for allocating the compulsory employer contributions.

(6) **Payment rules [KA 2006, s 101F]**

Compulsory employer contributions for an employee’s KiwiSaver scheme must be paid by the employer to Inland Revenue along with the PAYE tax deductions for the salary or wages to which they relate [see 860.85].

Compulsory employer contributions for an employee’s complying superannuation fund must be paid to the fund provider no later than one month after the payment of salary or wages to which they relate.

(7) **Rules for providers [KA 2006, s 101G]**

Compulsory employer contributions must be allocated by the provider across the investment products to which a member has subscribed or been allocated. The contribution vests in the member immediately after it is paid to the provider.

The provider of a KiwiSaver scheme must notify Inland Revenue of the date that a member will be entitled (under cl 4(3) of the KiwiSaver scheme rules) to withdraw their accumulated interest in the scheme. This must be done within the period of two months before the withdrawal date. Inland Revenue will then notify the employer of the date so that the employer can cease making compulsory employer contributions.

The provider of a complying superannuation fund must notify the member’s employer of the date that a member will be entitled (under a rule equivalent to cl 4(3) of the KiwiSaver scheme rules) to withdraw their accumulated interest in the fund. This must be done within the period of two months before the withdrawal date.

(8) **Complying superannuation funds [KA 2006, s 101H-101K]**

If an employer fails to pay a compulsory employer contribution to a complying superannuation fund the provider must, as soon as practicable, give notice to the employer requesting payment of the outstanding amount. A copy of this notice must be sent to the Government Actuary. If the employer does not pay the
outstanding contribution within one month, and the total unpaid compulsory employer contributions exceeds $500, the provider must immediately give notice to the Government Actuary. This notice must show:

(a) The employer’s name, address and tax file number (if known);
(b) The amounts of compulsory employer contributions unpaid;
(c) The names, addresses and tax file numbers of the employees to whom the failure to pay relates, and the relevant pay periods and amounts for each employee; and
(d) Other information required by the Government Actuary.

Where such a notice has been issued, the provider must immediately notify the Government Actuary of the details of any subsequent payment of overdue compulsory employer deductions made by an employer.

Upon receipt of a notice issued under s 101H(3) of the KA 2006, the Government Actuary must determine the amount of short payment by the employer, and then issue the employer with a notice containing the following details:

(a) The amount that the employer is required to pay to pay (liable amount);
(b) The relevant months and amounts;
(c) That the employer must pay the liable amount within 28 days after the notice is issued;
(d) The employer’s name, address and tax file number (if known);
(e) The relevant employees to whom the failure to pay relates, and their tax file numbers and addresses;
(f) The pay periods and relevant amounts for the employees to whom the failure to pay relates;
(g) That failure to comply with the notice will result in Inland Revenue receiving notice of the failure to comply; and
(h) Other information required by the CIR.

If the employer does not pay the overdue amount with 28 days (and the employer has not objected to the Government Actuary’s decision under s 186 of the KA 2006), the Government Actuary must immediately notify Inland Revenue of the following information:

(a) That the employer has failed to comply with notices under ss 101H(3) and 101I(3) of the KA 2006;
(b) The information set out in (a) to (h) above;
(c) The extent to which the liable amount remains unpaid;
(d) The relevant employees to whom the unpaid amount relates, their tax file numbers and addresses; and
(e) The pay periods and relevant amounts for the employees to whom the unpaid amount relates.

Where Inland Revenue is notified of unpaid compulsory employer contributions to a complying superannuation fund, the liable amount is treated as an amount due and payable by the employer to Inland Revenue on the 20th working day after Inland Revenue receives the notice. Inland Revenue will then notify the employer of the amount due and the due date.

Payments of overdue contributions received by the Government Actuary or Inland Revenue from the employer must be paid to the relevant provider, and the overdue amount is reduced accordingly.


An employee who is a member of a KiwiSaver scheme or a complying superannuation fund may apply for a contributions holiday. An employee can only apply for a contributions holiday once they have been making contributions for at least 12 months, unless the employee is suffering, or likely to suffer, financial hardship. Unless the employee is applying on the basis of financial hardship, the employee does not have to give a reason to apply for a contributions holiday. Provided the employee has been making contributions for at least
12 months, Inland Revenue must grant the application. When applying for a contributions holiday, the applicant must provide Inland Revenue with the following details:

(a) Their name, address and IRD number;
(b) The name and address of each employer to whom the holiday will apply;
(c) The period for which the holiday will apply (maximum five years);
(d) Details of the financial hardship (if applicable); and
(e) Any other information required by Inland Revenue.

If an employee has more than one employer, they can apply for a contributions holiday in respect of any one or more of those employers. If Inland Revenue is satisfied that the applicant has been making KiwiSaver contributions for at least 12 months or, if less than 12 months, is suffering or likely to suffer financial hardship, Inland Revenue must grant the applicant a contributions holiday. The way in which the CIR will exercise the discretion to accept or decline an application for a contributions holiday on the grounds of financial hardship is set out in SPS 07/04 [see TIB vol 19:6 (July 2007) at 56-58].

A contributions holiday granted for financial hardship is for a period of three months, although Inland Revenue can agree to a longer period. A contributions holiday granted in any other case must be for a minimum of three months and a maximum of five years. At the end of the holiday period, the employee can apply for a further contributions holiday. There is no restriction on the number of times a holiday can be applied for.

As soon as practicable after granting the contributions holiday, Inland Revenue must advise the applicant, each relevant employer and the provider of the KiwiSaver scheme. Each relevant employer must cease making deductions of contributions from the next payment of salary or wages that the employer calculates following receipt of the notice from Inland Revenue. An employee may use a contributions holiday, once granted, in respect of any other employer even if that employer was not named in the original application.

Before the end of a contributions holiday, Inland Revenue must notify the person to whom it relates and each affected employer known to Inland Revenue. The notice to an employer must advise the date on which the holiday ends and that deductions must recommence from that date. The employer must start making deductions of contributions from the next payment of salary or wages that the employer calculates following receipt of the notice from Inland Revenue.

A person who has been granted a contributions holiday may, at any time within the period of the holiday, revoke or reinstate their contributions holiday by notifying their employer accordingly provided they do not do so more frequently than once every three months.

If an employee who has a contributions holiday commences new employment but fails to provide the new employer with a copy of the notice from Inland Revenue granting the holiday (eg because the employee has lost or misplaced it), the employer will be required to make deductions of contributions. Once the employee finds or obtains a copy of the notice and shows it to their employer, the employer may then refund any deductions made previously. If the contributions have been paid to Inland Revenue, Inland Revenue may refund the money to the employee.

860.95 Refund due to financial hardship or serious illness [KA 2006, ss 113, 126, sch 1]

A person who is suffering, or likely to suffer, significant financial hardship or is suffering serious illness can apply to Inland Revenue for a refund of contributions being held in the holding account for the initial three-month period. There is no specific method for applying for a refund, provided the application tells Inland Revenue:

(a) The person’s name, address and tax file number;
(b) Details of the significant financial hardship or serious illness; and
(c) Any other information Inland Revenue requires.

Inland Revenue must refund the contributions if satisfied that:
(a) The applicant is suffering, or likely to suffer, significant financial hardship or is suffering serious illness; and
(b) Reasonable alternative sources of funding have been explored and exhausted.

Inland Revenue cannot refund employer contributions. The amount refunded may be limited to the amount that, in the CIR’s opinion, is required to alleviate the particular hardship.

“Significant financial hardship” is defined to include significant financial difficulties that arise because of:
(a) A member’s inability to meet minimum living expenses;
(b) A member’s inability to meet mortgage repayments on their principal family residence resulting in the mortgagee seeking to enforce the mortgage;
(c) The cost of modifying a residence to meet special needs arising from a disability of a member or a member’s dependant;
(d) The cost of medical treatment for an illness or injury of a member or a member’s dependant;
(e) The cost of palliative care for a member or a member’s dependant;
(f) The cost of a funeral for a member’s dependant; or
(g) The member suffering from a serious illness.

“Serious illness” means any injury, illness or disability that:
(a) Results in the member being unable to engage in work for which he or she is suited by reason of experience, education or training, or any combination of these things; or
(b) Poses a serious and imminent risk of death.

The way in which the CIR will exercise the discretion to refund or not refund contributions is set out in SPS 07/04 [see TIB vol 19:6 (July 2007) at 52-55].

(1) Persons affected by Canterbury earthquake aftershock – 22 February 2011

When considering an application for a refund of contributions due to significant financial hardship by a person affected by the Canterbury earthquake aftershock on 22 February 2011, the CIR must take into account financial difficulties caused by the following matters, in addition to those listed under (a) to (g) above:
(a) The destruction of or damage to the person’s property as a result of the aftershock;
(b) The person’s loss of employment as a result of the aftershock;
(c) Costs incurred by the person as a result of the aftershock (including costs associated with relocating to a new home or dealing with trauma).

Persons affected by the Canterbury earthquake aftershock are defined as KiwiSaver members residing in the district of one of the following territorial authorities at the time of the aftershock:
- Ashburton District Council
- Christchurch City Council
- Hurunui District Council
- Selwyn District Council
- Waimakariri District Council

These special rules apply only to applications received during the period 22 April 2011 to 22 January 2012. Refer KiwiSaver (Significant Financial Difficulties–Canterbury Earthquake) Regulations 2011.

860.100 Withdrawal to purchase first home [KA 2006, s 126, sch 1, cl 8]

A person who has been a member of a KiwiSaver scheme for at least three years may withdraw an amount not exceeding their accumulated balance in the scheme (excluding any Crown contribution and any amount transferred from an Australian complying superannuation scheme) to purchase their first home provided:
(a) The member has not made a withdrawal for this purpose before;
(b) The property is intended to be the principal place of abode of the member and their family (if any); and
(c) The member has not owned or had an interest in land before. The following estates in land are ignored for this purpose:
   (i) The person holds the estate in land as a bare trustee;
   (ii) The estate in land is a leasehold estate; or
   (iii) The person holds the estate in land as a trustee who is a discretionary, contingent or vested beneficiary under the trust, but has no reasonable expectation of being able to occupy the land as the principal place of residence of themselves or their family until the person who currently occupies the land, or their survivor, dies.

Any withdrawal for this purpose must be paid to the member’s solicitor and the trustees of the KiwiSaver scheme may require from the solicitor, before payment of the withdrawal:
(a) A copy of the sale and purchase agreement showing the member as purchaser;
(b) An undertaking that the agreement is unconditional; and
(c) An undertaking that the funds will be paid to the vendor or, if settlement is not completed, repaid to the trustees on account of the member.

Clause 8, sch 1 to the KA 2006 (which sets out the rules for withdrawal of contributions for the purchase of a first home), is subject to the terms of any participation agreement that restricts or prevents the withdrawal of employer vested contributions in relation to the member.

Note: Prior to 7 September 2010, a KiwiSaver member who had been a party to a rental lease agreement was prevented from withdrawing their contributions to purchase a first home. From that date, members with an interest or past interest in a leasehold estate are eligible for a first home withdrawal and are not excluded from eligibility for a first home deposit subsidy.

860.102 Mortgage diversion facilities [KA 2006, s 229, regs 21-29 KiwiSaver Regulations 2006]

Mortgage diversion facilities allow contributions to be withdrawn from a member’s KiwiSaver scheme or complying superannuation fund and applied towards the payment of amounts secured by certain mortgages over the member’s principal residence. The KiwiSaver scheme provider and the mortgagee must choose to participate in the facility.

Note: Mortgage diversion facilities were closed to new participants from 1 June 2009. The facility continues to be available to participants who applied before that date.

Any mortgage diversion facility must be in accordance with the following principles:
(a) There is no compulsion on providers to provide a mortgage diversion facility.
(b) There is no compulsion on mortgagees to allow KiwiSaver and complying superannuation fund contributions to be used to pay amounts secured by mortgages.
(c) The mortgage diversion facility is available at any time after 12 months have expired since the CIR or the provider (whichever is the earlier) receives the first contribution from the member.
(d) Mortgage diversion is available only in relation to a mortgage over the person’s principal residence.
(e) The mortgage diversion may apply for the remainder of the term of the mortgage after the diversion is made available, but only to the extent to which the mortgage continues to be over the person’s principal residence.
(f) After the total amount secured by the mortgage is paid, subsequent contributions are not diverted from the person’s KiwiSaver scheme or complying superannuation fund.
(g) If the person chooses to stop the mortgage diversion facility before the amount secured by the mortgage is repaid, the contributions are redirected towards retirement savings.
(h) The provider (not the CIR) is responsible for paying the amount diverted under the mortgage diversion facility.

(i) The amount diverted from a person’s KiwiSaver scheme or complying superannuation fund is a fixed dollar amount, capped at not more than the total of:
   (i) Half of the total contributions received by the KiwiSaver scheme provider; and
   (ii) Half of the person’s contributions to their complying superannuation fund, but limited to four per cent of their annual gross base salary or wages for each complying superannuation fund.

(j) Amounts received before the provider received the request to divert amounts under the mortgage diversion facility cannot be diverted.

(k) Employer contributions may not be diverted.

(l) An amount that was transferred from an Australian complying superannuation scheme may not be diverted.

(m) The facility is available for both new and existing mortgages [KA 2006, s 229].

A mortgage qualifies for participation in the mortgage diversion facility if:

(a) It is a mortgage over the mortgagor’s principal residence; and

(b) It secures obligations that arise under a home loan facility, even if the mortgage also secures other obligations.

A “home loan facility” specifically excludes a revolving credit contract that does not expressly provide for a credit limit that reduces over the term of the contract.

Diverted contributions may only be used to pay amounts (including principal, interest or other amounts payable) owing under the home loan facility secured by the mortgage. The member must not be able to access, withdraw or redraw any diverted contributions (in whole or in part), without making specific application to the mortgagee. This restriction applies even if the home loan facility:

(a) Is a reducing revolving credit contract; or

(b) Permits amounts that have been paid by that person over and above any repayment amount or minimum payments amount specified, or amounts that have been paid in advance of any specified schedule of repayments, to be accessed, withdrawn or redrawn or otherwise advanced to that member [KiwiSaver Regulations 2006, reg 29].

Regulations 24-28 of the KiwiSaver Regulations 2006 set out the procedures for a member to participate in a mortgage diversion facility, and the obligations of the member, provider and mortgagee in relation to the setting up and operation of the facility.

**860.103 First home deposit subsidy**

A person who has contributed to a KiwiSaver scheme or a complying superannuation fund for at least three years is eligible to apply for a first home deposit subsidy. The subsidy is $1,000 for each full year of contribution, up to a maximum of $5,000 per member. For a couple buying their first home, the maximum subsidy would therefore be $10,000.

To be eligible for the subsidy, a person must:

(a) Be 18 years of age or older;

(b) Not have received a first home deposit subsidy before;

(c) Be a member of a KiwiSaver scheme or a complying superannuation fund;

(d) Have contributed at least the minimum percentage of their income (four per cent between 1 July 2007 and 31 March 2009; two per cent from 1 April 2009) to a KiwiSaver scheme or a complying superannuation fund for at least three years. The three years of contributions do not need to be successive;
(e) Have a combined annual income of $100,000 or less before tax (for one or two buyers), or $140,000 or less before tax (for three or more buyers);

(f) Be buying one of the following property types:
   • Fee simple;
   • Stratum estate freehold and leasehold;
   • Cross-lease (freehold and leasehold); and
   • Leasehold land.

If the person is buying a building, they must also:

(a) Be buying their first home;

(b) Be buying a house within the maximum house price cap for the area. The cap is $400,000 for Auckland City, North Shore City, Rodney District, Wellington City and Queenstown Lakes District and $300,000 for all other areas;

(c) Be planning to live in the house.

If the person is buying land and planning to build a house on it, or buying an apartment that is being built, they must also:

(a) Be planning to live in the house or apartment;

(b) Have a house built within 12 months of purchase of the land;

(c) Be able to show that:
   • They will have funding for the construction of the building;
   • The total cost of the land and house or apartment is within the house price caps set out above; and
   • The land or site is ready to build on.

The first home deposit subsidy is a social assistance suspensory loan for the purposes of s EW 45 and is therefore tax-free [Schedule to Income Tax (Social Assistance Suspensory Loans) Order 1995, cl 1A].

For further information, see the Housing New Zealand Corporation website (www.hnzc.govt.nz).

860.105 Fees to be reasonable [KA 2006, ss 126, 189B, 189C, 225, sch 1, cl 2]

The KiwiSaver scheme rules require persons involved in the provision of the KiwiSaver scheme (such as the trustees, administrator, investment manager, and promoter) not to charge fees that are unreasonable. The Government has indicated that it will negotiate with scheme providers to keep fees as low as possible.

A KiwiSaver scheme provider who increases a fee must give notice of the increase to the Government Actuary as soon as reasonably practicable after the increase takes effect [KA 2006, s 189B]. The High Court may, on the application of a scheme member or the Government Actuary, order that a fee that is unreasonable be annulled or reduced. The application must be made within one year of the day the fee is imposed or debited [KA 2006, s 189C].

860.110 No Crown guarantee [KA 2006, ss 205, 206]

The Crown does not guarantee any KiwiSaver scheme or investment product of a KiwiSaver scheme.

The Crown or any other person does not perform a financial adviser service for the purposes of the Financial Advisers Act 2008 if the Crown or that person:

(a) Supplies an information pack;

(b) Gives a factual description to another person of the features of a KiwiSaver scheme or of KiwiSaver schemes (for example, information about admission as a member or termination of membership);

(c) Gives information of the type referred to in paragraph (b) in the course of promoting the benefits of retirement savings in general;

(d) Acts only as an intermediary who transmits information about a KiwiSaver scheme; or

(e) Otherwise exercises or carries out a function, duty, or power under the KA 2006.
The Crown must pay a contribution of $1,000 to the first KiwiSaver scheme of which a person is a member. The contribution must be paid before the member reaches the New Zealand superannuation qualification age. The contribution is paid only once — a person who ceases to be a member of a KiwiSaver scheme (eg because they leave New Zealand) and subsequently joins a KiwiSaver scheme again is not entitled to receive another contribution.

However, if a person ceases to be a member of the first KiwiSaver scheme they join, because the CIR accepts an opt-out notice outside the time limit or because the person’s enrolment is invalid, and the $1,000 Crown contribution was never paid, then the next KiwiSaver scheme of which the person is a member is treated as their first one for the purposes of the entitlement to the Crown contribution.

The contribution must be paid as soon as practicable after the earliest of the following dates:

(a) In the case of an employee, three months after the date on which Inland Revenue receives the first contribution for the person;

(b) In any other case, three months after the date on which Inland Revenue is given notice or otherwise knows that the person is a member of the KiwiSaver scheme.

If the person has transferred to their first KiwiSaver scheme from a complying superannuation fund, and they were a member of the fund for more than three months, the applicable date is the day on which Inland Revenue is notified that the person has transferred.

If the member has subscribed or been allocated to more than one investment product of a KiwiSaver scheme, the Crown contribution must be credited by the provider among the investment products using the contribution allocation. The contribution must vest in the member immediately after it is paid to the provider. The “Crown contribution” is defined to include both the initial $1,000 contribution explained above and the KiwiSaver tax credit under s MK 1 [KA 2006, s 4(1)].

Detailed rules govern the eligibility, registration, and operation of KiwiSaver schemes and their providers. Coverage of these rules is beyond the scope of this publication. Refer to Part 4 of the KA 2006 for details.

The KiwiSaver scheme rules in sch 1 to the KA 2006 are implied in every trust deed that establishes a KiwiSaver scheme. They apply despite anything to the contrary in the trust deed and are enforceable by the trustees, the manager, or any member of the scheme. The KiwiSaver scheme rules are in addition to (and are not overridden by) the provisions implied in the trust deed of a KiwiSaver scheme by ss 8 to 10 of the Superannuation Schemes Act 1989.

The KiwiSaver scheme rules cover the following matters:

• Application;
• Trustee’s duties;
• Manager’s duties;
• Scheme investments and property;
• Manager to provide information to trustee;
• Investment of scheme money;
• Fees charged by trustees, promoters, and so on, must not be unreasonable;
• Minimum contributions for employee members;
• Lock-in of funds until end payment date;
• Amounts from Australian complying superannuation schemes (not yet in force);
• Permitted withdrawals must be paid as lump sums;
• Evidence of right to make permitted withdrawal;
• Release of funds required under other acts;
• Withdrawal to purchase first home [see 860.105];
• Withdrawal on death;
• Withdrawal in cases of significant financial hardship or serious illness [see 860.95];
• Withdrawal or transfer to foreign scheme in cases of permanent emigration;
• Contributions holidays;
• Transfer of membership to another KiwiSaver scheme; and
• Restriction on the withdrawal of Crown contributions arising from a KiwiSaver tax credit.

860.125 Penalty for failure to provide information [KA 2006, ss 214, 215]
An employer who fails to provide information as required under Parts 2 or 3 of the KA 2006 is liable for a penalty. The penalty is $50 for small employers and $250 for other employers. The penalty cannot be imposed unless Inland Revenue has, within the preceding 12 months, sent the employer a notice stating that:
(a) A penalty will be imposed if the employer does not provide the required information; or
(b) The employer has been liable for the penalty in the preceding 12 months.
A “small employer” is an employer whose gross PAYE and ESCT deductions in the previous tax year were less than $100,000 in total. If the person was not an employer in the previous tax year, they are a small employer until the time when their gross PAYE and ESCT deductions in the current tax year exceed $100,000 in total.
An employer is not liable for more than one such penalty per month. The penalty is due and payable on the day the next tax deduction required to be made by the employer under the PAYE rules is due to be paid to Inland Revenue after the end of the PAYE period in which the failure occurred.
The penalty under s 215 of the KA2006 applies in addition to any penalties arising under the TAA.

860.135 Member tax credits [ss CX 50, MK 1, MK 2, MK 4]
(1) Entitlement [ss CX 50, MK 1, MK 2]
Persons who are members of a KiwiSaver scheme or a complying superannuation fund are entitled to a tax credit of 50 cents for each $1 contributed by the member, up to a maximum of $10 per week ($521.43 per year). The credit is paid to the member’s fund provider, not to the member directly. Tax credits paid under Subpart MK are excluded income of the person deriving them [s CX 50].

Example:
Andrew joined KiwiSaver on 1 July 2011. For the year ended 30 June 2012, he earned gross wages of $32,875. He contributed four per cent of his wages ($1,315) to a KiwiSaver scheme. The member tax credit is the lesser of 50 per cent of his contributions ($657.50) and $521.43. At the end of the year he will be entitled to a tax credit under s MK 1 of $521.43. The total contributions to his KiwiSaver scheme for the year (not including any employer contributions) are therefore $1,836.43.

Note: For years ending before 1 July 2011, the maximum member tax credit was $1,042.86 a year.
A person qualifies for the credit for the year ended 30 June if the person:
(a) Has creditable membership of a KiwiSaver scheme or a complying superannuation fund (see below);
(b) Is 18 years or older;
(c) Is not entitled to withdraw an amount from the scheme or fund because the end payment date has been reached; and
(d) Has their principal place of residence in New Zealand (but see the exceptions below).
A person whose principal place of residence is not in New Zealand still qualifies for the tax credit if:
(a) They are a State services employee who is serving outside New Zealand; or
(b) They work overseas as a volunteer (or for token payment) for a charitable organisation listed in 1380.20 and the work is of the following type:
   (i) Work to relieve poverty, hunger, sickness or the ravages of war or natural disaster;
(ii) Work to improve the economy of a country that is recognised by the United Nations as a developing country; or

(iii) Work to raise the educational standards of a country that is recognised by the United Nations as a developing country.

Written evidence must be given to the fund provider showing why and for what period they satisfied one of these exceptions.

“Creditable membership” means membership in a KiwiSaver scheme or a complying superannuation fund. For this purpose, membership (and therefore eligibility for the member tax credit) commences on the earlier of:

(a) The first day of the month in which contributions are deducted from an employee’s salary or wages;

(b) The first day of the month in which a contribution is first received by Inland Revenue for a person; or

(c) The first day of the month in which securities are allotted by the KiwiSaver scheme or a complying superannuation fund.

A special transitional rule applies when contributions are received by either Inland Revenue or a KiwiSaver scheme between 1 July and 31 October 2007. In this situation, membership commences on the first day of the month in which a KiwiSaver scheme receives a valid application for membership.

(2) **Calculation [s MK 4]**

The calculation of the member tax credit for a member credit year (a year ended 30 June) involves two steps:

(a) Step 1: Calculate the amount of member credit contributions per day using the following formula:

\[
\frac{\text{member credit contributions}}{\text{included days}}
\]

If the result of this calculation is less than $1.429 (\$521.43 / 365) the member tax credit is equal to the member credit contributions for the year. If the result of this calculation is equal to or greater than $1.429, go to Step 2.

(b) Step 2: If the result of the calculation in Step 1 is equal to or greater than $1.429, the member tax credit is equal to the amount calculated using the following formula:

\[
\frac{\$521.43 \times \text{included days}}{365}
\]

“Member credit contributions” means the total of the person’s member credit contributions to all of their complying superannuation funds and KiwiSaver schemes for the member credit year, together with amounts received and held by the CIR but not passed on to the scheme provider until after the end of the member credit year. Specified superannuation contributions (employer contributions) withdrawn under a mortgage diversion facility [s YA 1].

“Member credit contribution” means an amount of a superannuation contribution to the person’s KiwiSaver scheme or complying superannuation fund, including an amount received and held for the person by the CIR in the holding account, but excluding:

(a) An employer’s superannuation cash contribution made for the person;

(b) A contribution withdrawn under a mortgage diversion facility;

(c) Crown contribution for the person.

“Included days” means the number of days in the member credit year on which the person satisfies the requirements of s MK 2 (as explained above).

**860.140 Payment, treatment and claiming tax credits [ss MK 3, MK 5, MK 6, MK 7; TAA, 68C]**

(1) **Payment [s MK 3]**

The CIR pays the tax credit by direct credit to the member’s fund provider. The fund provider must claim the credit (see below). The credit must be paid by the CIR to the fund provider within 30 working days of
receipt of the claim form. The CIR is not allowed to deduct or set-off, against the tax credit, any amounts owing to the CIR by the member or the member’s fund provider.

If a member transfers to a new fund provider, the CIR can pay the credit to the new fund provider. The credit can be paid directly to the member (or their estate) if the member dies or their account with the provider is closed.

(2) **Treatment** [ss MK 5, MK 6, MK 7, MK 8]

The tax credit is treated as a Crown contribution and is subject to the relevant KiwiSaver scheme rules and complying fund rules. The fund provider is treated as having received the tax credit, for recovery purposes. The fund provider must credit the amount of the tax credit across all the investment products to which the member has subscribed or been allocated, on the same basis as the contributions are allocated. The tax credit vests in the member immediately after it is received by the fund provider.

If an amount of tax credit is overpaid, the fund provider may remove the overpayment from the member’s account in order to repay it to the CIR. This overrides any rules to the contrary in the KiwiSaver scheme or complying superannuation fund.

If a person emigrates permanently from New Zealand to a place other than Australia and requests a withdrawal or transfer from their KiwiSaver scheme or complying superannuation fund, the fund provider must pay the CIR the lesser of the following amounts:

(a) The total amount of the tax credits that have been paid for the person and are held by the fund provider;
(b) The amount of the employee’s superannuation accumulation (for a complying superannuation fund); or
(c) The amount of the member’s accumulation.

A person who emigrates permanently from New Zealand to Australia is unable to withdraw their KiwiSaver savings in cash but may transfer their account balance (including member tax credits and Crown contribution) to an Australian complying superannuation fund. See 860.150.

The “member’s accumulation” means the net value of the total of:

(a) The member’s contributions;
(b) Any vested employer contributions;
(c) Any fee subsidies; and
(d) The Crown contribution (including both the initial $1,000 and the s MK 1 tax credits).

(3) **Claiming tax credits** [TAA, s 68C]

The fund provider must claim the tax credit by completing a member credit claim, in the form prescribed by the CIR. The claim must contain the member’s name, address, and (if known) tax file number, the amount of the person’s member credit contributions (as defined in 860.135) for the year, and any other information required by the CIR. The claim must be furnished by the due date (yet to be advised by the CIR).

The fund provider must claim the tax credit for each person who is a member of the fund on 30 June each year, or who ceases to be a member during the year due to permitted withdrawals other than transfers. Before claiming the credit, the fund provider must:

(a) Be “reasonably satisfied” of the number of days that the member had their principal place of residence in New Zealand; and
(b) Have no knowledge that the person does not meet the other requirements of s MK 2.

A fund provider can claim a credit for a member for an earlier year if not previously claimed.

**Employer tax credit**

The employer tax credit, of up to $20 per week per employee, was available to employers who (between 1 April 2008 and 31 March 2009) made voluntary or compulsory contributions to KiwiSaver schemes and
complying superannuation funds for their employees. The employer tax credit was repealed from 1 April 2009. See Staples Tax Guide 2009 860.145 for details.

860.150 Trans-Tasman portability of retirement savings [s CW 29B; KA 2006, sch 1, cl 4B, 14B]

Note: The following rules are not yet in force. See the information on the application date below.

(1) Introduction
A person who moves permanently from New Zealand to Australia is able to transfer their KiwiSaver contributions to an Australian complying superannuation fund. Conversely, a person emigrating to New Zealand from Australia can transfer their retirement savings from an Australian complying superannuation fund to a KiwiSaver scheme. This arrangement is intended to make it easier to transfer retirement savings across the Tasman, to improve labour mobility between the two countries.

The portability arrangements are the only way for KiwiSaver members to take their accumulated savings with them when they move permanently to Australia. Consequently, KiwiSaver members who emigrate to Australia will not be able to withdraw their accumulated savings in cash.

(2) Qualifying schemes
Retirement savings may only be transferred between a KiwiSaver scheme and an Australian complying superannuation fund regulated by the Australian Prudential Regulation Authority. Members of New Zealand complying superannuation funds are not able to transfer their savings to Australia.

An “Australian complying superannuation scheme” is an entity that is a complying superannuation fund for the purposes of Part 5, Division 2 of the Superannuation Industry (Supervision) Act 1993 (Aust) and that is regulated by the Australian Prudential Regulation Authority [s YA 1; KS, s 4].

(3) Transfer optional
A KiwiSaver member emigrating to Australia can choose whether or not to transfer their KiwiSaver balance to Australia. Providers of savings schemes do not have to accept a transfer.

(4) Permanent emigration
A transfer can be made only if the KiwiSaver member is emigrating permanently to Australia; proof of emigration must be supplied to the Australian provider. The requirements for proof of permanent emigration, which must be supplied to the scheme provider before the savings can be transferred, are set out in cl 14, sch 1 of the KA 2006.

(5) Tax implications on transfer
Income derived in an income year by a natural person from an Australian complying superannuation scheme is exempt income if, in the income year, it is contributed to a KiwiSaver scheme [s CW 29B]. This means there are no income tax implications for a person transferring their savings from an Australian complying superannuation scheme to a KiwiSaver scheme.

Transfers of savings from New Zealand to Australia are not subject to tax in Australia. Distributions from a KiwiSaver scheme to Australian non-residents are not treated as dividends and so are not subject to NRWT.

(6) Australia’s excess non-concessional contributions tax
Australia imposes a tax-free limit (a “non-concessional contributions cap”) of A$150,000 on the amount of superannuation contributions that an individual can make from non-wage sources in a particular year. Contributions that exceed this cap are taxed at a rate of 46.5 per cent. The tax is intended as a disincentive for people to accumulate excessive contributions in superannuation funds, because Australian superannuation funds are taxed on their earnings at concessional rates (15 per cent) and pensions paid out of such funds are typically tax-free after 60.

Transfers from KiwiSaver to an Australian superannuation scheme are subject to the non-concessional contributions cap on initial entry into the Australian system. This is intended to maintain the integrity of the
Australian superannuation system. The cap does not apply to New Zealand-sourced or Australian-sourced superannuation contributions re-entering Australia.

However, an individual under 65 can bring forward the contributions for the next two years, so can in fact contribute up to A$450,000 in any particular year without breaching the contributions cap. The cap will be indexed to inflation from 2010-2011.

(7) **Prohibition on cash withdrawal**

Generally, KiwiSaver members who permanently emigrate overseas are able to withdraw their savings in cash one year after emigration. Any member tax credits that the person has accumulated cannot be withdrawn, and will be recovered by the Crown (KA 2006, cl 14, sch 1).

However, KiwiSaver members who permanently emigrate to Australia cannot withdraw their savings in cash. They must either transfer them to an Australian complying superannuation fund or leave them in the KiwiSaver scheme.

(8) **Amounts transferred**

A KiwiSaver member can request that their savings be transferred any time after supplying the provider with proof of their permanent emigration to Australia. The member must transfer the full amount of their savings — partial transfers are not permitted.

KiwiSaver members transferring their retirement savings to Australia can take their accumulated member tax credits (up to $1,042.86 per year) and $1,000 Crown contribution with them. Member tax credits are recovered by the Crown if a member withdraws his or her savings following permanent emigration from New Zealand to any country other than Australia.

The transferred retirement savings must be separately identifiable within the account established in the country to which the savings are transferred.

(9) **Prohibition on transfer to a third country**

New Zealand-sourced retirement savings may not be transferred from Australia to a third country. Similarly, Australian-sourced retirement savings may not be transferred from New Zealand to a third country.

(10) **Rules applying to transferred funds in Australia**

Retirement savings transferred from KiwiSaver to Australia remain locked in until the member reaches the age of entitlement to New Zealand Superannuation (currently 65).

Any New Zealand-sourced retirement savings that are transferred to Australia are not be able to be transferred from Australia to a third country.

(11) **Rules applying to transferred funds in New Zealand**

A person who is retired may withdraw their Australian-sourced retirement savings from KiwiSaver at age 60 (KA 2006, sch 1, cl 4B). This is consistent with the Australian rules on the withdrawal of retirement savings, and ensures that an individual is not disadvantaged by moving from Australia to New Zealand.

The member tax credit of up to $1,042.86 per year is not paid on contributions to KiwiSaver schemes consisting of Australian-sourced retirement savings.

Australian-sourced retirement savings may not be withdrawn to purchase a first home, diverted to a member’s mortgage repayments under the mortgage diversion facility, or used to count towards eligibility for the deposit subsidy. However, any earnings on Australian-sourced savings may be withdrawn for the purchase a first home.

(12) **Application date**

The new rules will apply from the first day of the second month after the month in which the Governments of New Zealand and Australia exchange notes, as provided by cl 21 of the Arrangement between the two Governments on trans-Tasman retirement savings portability.
# Chapter 880
## Land Sales

### 880.05 Definitions

The term “land” includes:

(a) Any estate or interest in land; and

(b) Any option to acquire land or any such estate or interest in land, but does not include a mortgage.

The definition encompasses all of the following:

(a) Some or all of a parcel of land;
Land Sales

(b) Land together with any other land. Thus, a person could acquire an undivided interest in a parcel of land with the purpose or intention of disposing of it and be liable for tax on any profit, notwithstanding that the owner of the other undivided interest would not be taxable because that other person did not acquire the interest for disposal. All buildings on the land are included in the definition of “land”;

(c) A legal estate or interest, being that proprietary interest which has been acquired with all of the formalities required by common law or statute for conferring complete ownership;

(d) An equitable interest, being one under which there is no legal estate or interest vested in the person having the interest, but the person may have entered into a binding contract to purchase the property;

(e) Corporeal property, being something tangible as opposed to incorporeal property. Actual possession of land would be corporeal but an undivided interest, or a right as a remainderman in an estate, would be incorporeal;

(f) Freehold interests being interests that gives the owner the largest rights of use and enjoyment allowed by the law together with the fullest power of alienation; and

(g) Chattel interests, meaning something less than the freehold (e.g., leasehold). “Disposition” of land includes compulsory acquisition under any Act by the Crown or by any public authority or by any local authority. This provision is necessary because otherwise a landowner could avoid the tax by simply refusing to negotiate voluntarily, thus forcing a compulsory acquisition.

“Improvements” means improvements to land that are not minor and which are made by a taxpayer or by an associated person of the taxpayer. The improvement may be by way of erecting a building or otherwise. The definition applies for the purposes of s CB 7 (disposal land acquired for purposes of a business relating to erecting buildings on land) and s CB 11 (disposal by a person in the business of erecting buildings (or associate) where the land is sold within 10 years of completing the improvement) [see 880.35].

880.10 Meaning of associated persons in land transactions
The “1973 version provisions” definition of associated persons applies for the purposes of the land sales provisions [see 70.25].

880.15 Legislation
Although ss CB 6 to CB 15 apply specifically to land sales, other provisions in the legislation may be used to impose income tax on land sale transactions such as:

(a) Business profits [s CB 1];

(b) A profit-making undertaking or scheme [s CB 2];

(c) Income under ordinary concepts [s CA 1(2)].

In TRA Case S86 (1996) 17 NZTC 7,538, these provisions were considered in the sale of 20 properties within a three-year period. The gains were held to be not liable for income tax because the sales were made to wind down a real estate portfolio rather than to make a profit.

880.20 Sale of land acquired for disposal [s CB 6]
Income includes all profits or gains derived from the disposition of any land if the land was acquired for the purpose or intention of selling or otherwise disposing of it. If, at the time of acquisition of the land, one of the purposes or intentions of the acquisition was a resale of all or part of that land, the profits are assessable. The purpose or intention would have to clearly evidence itself at the time of acquiring the land.

There are no time limits. If, at the time the land was acquired, there was a clear purpose of selling, any profit ultimately made is taxable.

Difficulties may arise by reason of the fact that an eventual sale at some future date may be contemplated whenever any land is acquired. However, it is to the more prominent purposes and intentions of the taxpayer at the time of acquisition that the legislation is directed. The taxpayer must, at least, demonstrate that it was not the dominant or main purpose or intention to acquire the land for resale. Such a conclusion is drawn from the sequence of events surrounding and following the acquisition, such factors being:
(a) The period lapsing before the land is sold;
(b) What the land was used for in the period between acquisition and sale;
(c) The intervening circumstances and any changes occurring; and
(d) Realistic rates of return at the time of acquisition from an investment point of view.

These events would be examined as a measure of consistency with those intentions and purposes as expressed by the taxpayer.

Exclusions from the operation of s CB 6 are provided for the taxpayer’s residence [s CB 16] and the taxpayer’s business premises [s CB 19, see 880.40].

(1) Case law

In *Junior Farms Ltd v Commissioner of Inland Revenue* HC Auckland CIV-2009-404-2870, 22 July 2011 the taxpayer company owned land which it had used for dairy farming since 1964. Over time, the local authority rezoned the land such that some of it was designated light industrial and some flood plain. In November 1994, the company entered into an agreement to sell the land. Two agreements and a side letter from the buyer to the seller were signed. The first agreement sold the entire land, buildings, plant and livestock to the buyer for approximately $2.7 million. The second agreement, dated the following day, sold back to the company around 14 hectares of the land (being the flood plain) for $100. The side letter clarified certain aspects of the contracts. The flood plain was later sold to the local authority for $3 million. The CIR assessed a profit of $2,999,900. The CIR’s basis of assessment was that the taxpayer had acquired the land for $100 with the intention of disposing of it to the local authority. Brewer J found for the taxpayer. He held that the two agreements and the side letter should be read as one agreement. The taxpayer had not sold the flood plain but had maintained beneficial ownership of it. The two agreements had created a constructive trust over the legal title to the flood plain in favour of the taxpayer. The taxpayer had continued to own and farm the flood plain until such time as it was eventually sold to the local authority. Therefore, the taxpayer had not acquired the land in 1994 with the intention of disposing of it. Rather, the taxpayer had acquired the land in 1964 with the intention of using it in a farming business.

In *Commissioner of Inland Revenue v Boanas* (2008) 23 NZTC 22,046 (HC) the taxpayers sold rural freehold land to their family company and were each assessed on their share of the sale price on the ground that they had acquired the land with the purpose or intention of disposing of it. The land had previously been farmed under a pastoral lease granted by the Crown. The High Court found in favour of the taxpayers. Dobson J stated that the process of reconstructing purpose or intention at the time of acquisition should begin with, and in most cases be answered by, the attribution of purposes or intentions to the partnership, not to individual partners. It is the partnership that undertakes transactions such as acquisition and disposal of land, and individual partners cannot be divergent to the partnership rationale, except in limited circumstances, which might amount to a breach of fiduciary obligations to the remaining partners.

In *TRA Case C22* (1978) 3 NZTC 60,218, (1978) 2 TRNZ 545, a taxpayer purchased a block of land with the intention of disposing of it at some indeterminate time in the distant future. It was claimed that the land was purchased as an investment for retirement. However, the TRA was satisfied that, when the block was purchased, the dominant purpose of the taxpayer was to sell it, the only question being as to when it would be sold. The purpose went beyond being a mere hedge against inflation. In fact, the sale took place eight years after the date of purchase. The decision was given under the old s 88(1)(c) of the ITA 1954 when the test of assessability was the dominant purpose of sale. There would be a stronger case for assessment under s CB 6 since it now applies even where only one of the purposes is to sell the property.

The fact that a venture proved unworkable cannot be used in considering intention at time of acquisition: *TRA Case L72* (1989) 11 NZTC 1,419.

Evidence of intention at date of acquisition was obtained by reference to a bank manager’s diary notes and the reasons for purchase disclosed on a statutory Land Valuation Court declaration filed at time of purchase: *TRA Case H101* (1986) 8 NZTC 683.
Reference was made to a bank memorandum outlining intention at time of acquisition: TRA Case H108 (1986) 8 NZTC 720.

Reference was made to a brochure prepared for potential investors and to a special partnership agreement for the purpose of eliciting the intention of directors of a private company at time of purchase of land: Aotea Group Securities Ltd v Commissioner of Inland Revenue (1986) 8 NZTC 5,052 (HC).

Reference was made to a bank manager’s memorandum concerning a “spec house”: TRA Case K21 (1988) 10 NZTC 218.

Profits on sale were not assessable, the intention of sale only crystallising after acquisition: TRA Case K34 (1988) 10 NZTC 302.

A principal shareholder and director of a stevedoring company formed a syndicate to purchase a six-acre block adjacent to a wharf in 1965. In 1968 his syndicate share was transferred to his family trust which derived the profit when the land was sold in 1969. The CIR included the profit in the trust’s income and claimed the property had been purchased with the intention of resale. The Court held that the dominant purpose of purchase was to retain the land for the benefit of the stevedoring company and not for the purpose of resale: Maritime Trust v Commissioner of Inland Revenue (1983) 6 NZTC 61,537 (HC).

A builder in partnership with his wife had built four residential properties in succession on 10-acre blocks with the average time of ownership for each being 30 months, using short term finance to assist in the purchase of land and erection of the houses and temporary accommodation between the moves from house to house. It was held that the objectors had failed to show on the balance of probability that, at the time of acquisition of each of the pieces of land, they did not have a significant purpose or intention of selling or otherwise disposing of that land and thus it was assessable. Furthermore, all sales produced income that could be assessed as a sale of land by a builder with no exemption available: TRA Case M102 (1990) 12 NZTC 2,634.

Profits made from properties sold in order to terminate a property letting business (necessary through unforeseen financial commitments) were not part of the letting activity nor an “ordinary incident” of that activity, but were a “one-off transaction package of a capital nature” to wind down that letting business. Therefore, the profits were capital rather than revenue: TRA Case S36 (1995) 17 NZTC 7,237.

In TRA Case W2 (2003) 21 NZTC 11,003, the taxpayer failed to prove that a property that had been sold at a loss had been acquired with the intention of resale. Any intention that the majority of the partners may have had was irrelevant because it could not be enforced without the consent of all of the other partners.

880.25  Sale of land by dealer or associated person [ss CB 7, CB 9]

Special rules apply to the sale of land by either:

(a)  A person who is in the business of dealing in land at the time at which the land is acquired; or

(b)  An associated person of a person who is in the business of dealing in land at the time at which the land is acquired.

The test of association is applied only at the time at which the land is acquired.

The impact of the rules depends on whether or not the land was acquired for the purpose of the land dealing business.

Where the land was acquired for the purpose of the business, the proceeds of any disposal will be subject to tax regardless of the number of years for which the land has been owned [s CB 7].

Where the land was acquired other than for the purpose of the business, the proceeds will be taxable only where the land is disposed of within 10 years of the date on which it was acquired [s CB 9].

A sale by an “associated person” of a dealer ranks on all fours with a sale by the dealer personally, except that the profit is assessed to the associated person and not to the dealer.

Exclusions from the operation of these provisions are provided for the taxpayer’s residence [s CB 16] and the taxpayer’s business premises [s CB 19, see 880.40].
Case law

The accepted test under which to determine whether or not a person is a land dealer is found in Bates v Commissioner of Inland Revenue (1955) 6 AITR 283 (SC), where Henry J said:

“A person may engage in more than one business at the same time, and the Court is concerned only with the question of whether or not at any material time the appellant was engaged in the business of dealing in land. It is to be noted that it must be a business of dealing. ‘Dealing’ connotes buying and selling or exchanging land. To constitute a business of dealing when a person does not hold himself out as carrying on such business, generally speaking, the law requires a reasonable frequency of transactions or some continuity of effort for the buying, selling or exchanging of land. Even where there are a number of transactions concerning land, they may well have some other explanation. The sales and purchases may be entirely for personal reasons. They may constitute a form of investment or change of investment with the object of getting a return from the property in preference to other forms of investment of money. It is a question of fact or inference from fact in each case. Sometimes it is difficult to draw the dividing line, and other times it is clear that the case falls on one side or the other. Each case must be decided on its own facts.”

This principle was confirmed by the Court of Appeal in Williams Property Developments Ltd v Commissioner of Inland Revenue (1980) 4 NZTC 61,537 (CA), where a dealer company which transferred to an associated company land acquired three years previously was held to be transferring trading stock.

Where a land dealer acquired land which was aggregated to a farm prior to the gifting of the farm to a family trust, it was held to constitute trading stock disposed of without consideration: Margan v Commissioner of Inland Revenue (1978) 3 NZTC 61,259 (SC).

A taxpayer company was assessed on profits arising from the sale of lots from a block of land. The deciding issue was whether another company, with mutual shareholders, was carrying on the business of dealing in land at the time the taxpayer acquired the block of land. The TRA held that the “other” company was at the relevant time a dealer in land and, because it was “associated” with the taxpayer, the profits from the sale of the land were assessable: TRA Case 45 (1980) 3 TRNZ 647.

In Kenneth James Ltd v Commissioner of Inland Revenue (1983) 6 NZTC 61,565 (HC), the taxpayer was engaged in two activities:

(a) Dealing in land, the proceeds of which were assessable; and
(b) Acquiring investment properties, the profits from which were treated as capital.

The CIR assessed profits on sale of five properties as belonging to the former category. The High Court held that the circumstances of acquisition and sale of each property should be examined in the context of the development of the taxpayer’s business and their characteristics to determine liability.

The nature, pattern, financial result, character, statements connected with, and extent of the taxpayer’s property dealings left no doubt the taxpayer was in business as a dealer in real property: TRA Case F154 (1984) 6 NZTC 60,330.

Hotel managers were held to be in the business of buying and selling farm properties, and farming being only incidental in intent and results: TRA Case K42 (1988) 10 NZTC 354.

Sale of land by developer or associated person [s CB 7, CB 10]

Special rules apply to the sale of land by either:

(a) A person who, at the time at which the land is acquired, is in the business of developing land or dividing land into lots; or

(b) An associated person of a person who, at which the land is acquired, is in the business of developing land or dividing land into lots.

The test of association is applied only at the time at which the land is acquired.
The impact of the rules depends on whether or not the land was acquired for the purpose of the business.

Where land was acquired for the purpose of the business, the proceeds of any disposal will be subject to tax, regardless of the number of years for which the land has been owned [s CB 7].

Where land was acquired other than for the purpose of the business, the proceeds will be taxable only where the land is disposed of within 10 years of the date on which it was acquired [s CB 10].

A sale by an “associated person” of a dealer ranks on all fours with a sale by the developer or subdivider personally, except that the profit is assessed to the associated person and not to the developer or subdivider.

Exclusions from the operation of these provisions are provided for the taxpayer’s residence [s CB 16] and the taxpayer’s business premises [s CB 19, see 880.40].

880.35 Sale of land by builder or associated person [ss CB 7, CB 11]

Special rules apply to the sale of land by either:

(a) A person who carries on the business of erecting buildings; or
(b) An associated person of a person who carries on the business of erecting buildings.

The impact of the rules depends on whether or not the land was acquired for the purpose of the business of erecting buildings.

The type of business with which ss CB 7 and CB 11 are concerned is the business of erecting buildings. A builder may be in the business of building only things other than buildings (eg fences) in which case that person is not carrying on the type of business with which the provision is concerned. Whether or not a person is a qualified builder is irrelevant.

1) Land acquired for the purpose of the business [s CB 7]

If the land was acquired for the purpose of the business of erecting buildings, any disposal of the land will be taxable where:

(a) At the time at which the land was acquired the person or an associated person carried on a business of erecting buildings; and
(b) Either before or after acquiring the land, the person or the associated person made improvements to it.

The proceeds of any disposal will be subject to tax regardless of the number of years for which the land has been owned.

2) Land acquired other than for the purpose of the business [s CB 11]

Where the land was acquired other than for the purpose of the business, the proceeds will be taxable only where all of the following apply:

(a) The person carries out improvements to the land;
(b) The land is disposed of within 10 years of the date on which the improvements are completed; and
(c) At the time at which the improvements were commenced, either the person or an associated person of the person carried on the business of erecting buildings.

The test of association in this case is applied at the date on which the improvements are commenced.

TaxNote: The definition of “improvements” excludes improvements of a minor nature.

Exclusions from the operation of these provisions are provided for the taxpayer’s residence [s CB 16] and the taxpayer’s business premises [s CB 19, see 880.40].

3) Case law

Profits were assessable on the sale of land acquired 35 years previously for the purpose of constructing houses which would be let at nominal rental to long-term employees. It was held that the provision of employee
housing was part of the company’s income earning process and that the land had been acquired for the purpose of the company’s business: *TRA Case L65* (1989) 11 NZTC 1,381.

The capacity in which a taxpayer acts when carrying on the business is important to the associated persons test. In *TRA Case L72* (1989) 11 NZTC 1,419, the taxpayer was a trustee of a family trust and also controlled and managed MA Ltd. The trust purchased sections and contracted for MA Ltd to erect flats on them at cost price. Financial pressures caused the trustees to sell the land at valuation to the taxpayer personally. The CIR assessed the trustees on profits on the basis that the taxpayer carried on the business of erecting buildings or an associated person of the taxpayer carried on that business. It was held that the taxpayer was the trustee and it did not carry on the requisite business. Although A managed MA Ltd he did so in his personal capacity and although the taxpayer, in this personal capacity, and the company were associated persons, the company and the trustees were not.

880.40 Dwellings and business premises exempted from tax on sale

[ss CB 16, CB 19]

The sale of domestic dwellings and business premises are exempt in the foregoing circumstances [ss CB 6 to CB 11] except where a regular pattern of such transactions has emerged.

Section CB 19 allows an exemption for land which is acquired and occupied by the taxpayer primarily and principally as premises from which substantial business is carried on by the taxpayer. Premises used for storage only of materials, for example, are not premises from which substantial business is carried out. Premises from which rental income is derived are not within the term “business premises” and therefore not within the exemption: *TRA Case D20* (1979) 4 NZTC 60,558.

Section CB 16 allows an exemption for land on which a dwelling house is acquired and occupied, or erected by the taxpayer primarily and principally as a residence for the taxpayer and (if applicable) the taxpayer’s family. The land area is not to exceed 4,500 square metres, or such larger area as is required for the reasonable occupation and enjoyment of that dwelling house. This exemption is sufficient to cover most residences and holiday homes.

The CIR has stated that, where a taxpayer has purchased a section for possible future erection of a residence, holiday dwelling, or perhaps for recreational use, its subsequent sale will not normally attract tax. However, if it is clear that the original purchase included a greater area than was required for this primary purpose, and it was intended from the outset that this surplus area would be sold, the subsequent sale would come within s CB 5 purpose and intention to sell.

Neither of the exemptions applying to residential land and business premises is available where a regular pattern of purchase and sale transactions has emerged.

In *Parry v Commissioner of Inland Revenue* (1984) 6 NZTC 61,820 (HC), the taxpayers were shareholders in a company which carried on business as a builder. They purchased a 10-acre block on which they built their home. When they sold the property the CIR assessed the profits on sale as it was the fourth property the taxpayers had bought and sold in 14 years. The CIR submitted the exemption was not available as the land occupied by the dwelling was larger than reasonably required. He further submitted that a regular pattern of transactions had emerged. The High Court held that:

(a) The area of land was necessary for the reasonable enjoyment of the dwelling house; and
(b) Although a “pattern” of transactions had emerged they were not “regular”.

Hence the profit on sale of the property was not taxable.

A “regular pattern” of transactions was found to exist where a builder had on three occasions acquired a vacant situation, erected a family residence, and lived there for a short while before selling the property. Inferences of a regular pattern may be drawn from a period in which similar actions displaying a definite course of action or conduct are taken, although not necessarily in an identical manner, on at least two or more occasions: *TRA Case M102* (1990) 12 NZTC 2,634.
880.45  **Sale of land in scheme of development or subdivision within 10 years** [ss CB 12, CB 17, CB 20, CB 21, CB 23]

Income of a taxpayer includes all amounts derived from disposing of land where all of the following apply:

(a) An undertaking or scheme (whether or not in the nature of business) is carried out on, and involves the development of, the land or the division of the land into lots;

(b) The development or division work on or relating to the land is carried on by or on behalf of the taxpayer;

(c) The work is not minor; and

(d) The undertaking or scheme was commenced within 10 years of the date on which the taxpayer acquired the land.

The undertaking or scheme need not be an adventure in the nature of a trade or business. It had been accepted that the scheme or undertaking must involve the activity of subdivision or development with a view to sale. The CIR had indicated that it regarded an undertaking or scheme as existing where the scheme involves the sale of the property. For the profit to be assessable under the paragraph the undertaking must have been carried out with a view to sale.

Exclusions from the operation of s CB 12 are provided under the following four circumstances:

(a) Taxpayer’s residence;

(b) Business premise;

(c) Farm land; and

(d) Investment properties.

1) **Taxpayer’s residence** [s CB 17]

The following two circumstances each provides an exclusion from the operation of s CB 12:

(a) The purpose of the development, division or improvement to provide a private residence for the taxpayer and any member of the taxpayer’s family living with the taxpayer; or

(b) An area of land of not more than 4,500 square metres, which was occupied mainly as residential land for the taxpayer and a member of the taxpayer’s family, has been divided into two or more lots and it is one of those lots that has been disposed of.

2) **Business premise** [s CB 20]

Section CB 12 does not apply where the purpose of the work is to create or effect a development, division or improvement for use in the taxpayer’s business (not being the undertaking or scheme).

3) **Farm land** [s CB 21]

Section CB 12 does not apply where all of the following tests are met:

(a) Land which was used or occupied by the taxpayer, taxpayer’s spouse [see 960.10], or both of them mainly for the purposes of a farming or agricultural business has been divided into lots;

(b) The lot that has been sold is one of those lots;

(c) The lot that has been sold is of such area and nature that it is capable of being worked as an economic farming or agricultural unit; and

(d) The land was disposed of mainly to be used in a farming or agricultural business.

For discussion on what constitutes an “economic unit” [see 880.55].

Matters to be taken into account when deciding whether the last of these criteria has been met are:

(a) Consideration for the disposal;

(b) Current land prices in that area;

(c) Terms of the disposal;
(d) Zoning or classification of the land; and
(e) Proximity of other land being used or developed for non-farming, non-agricultural purposes.

(4) **Investment properties** [s CB 23]

Section CB 12 does not apply where the division, development or improvement is for use in deriving from the land income from a lease, licence or easement or the granting of a right to take profits from the land.

(5) **Case law**

The concept of carrying on business on or from the land conveys something more permanent than the use of the land as a building site for buildings to be sold on with the subdivided lots: *TRA Case J37* (1987) 9 NZTC 1,219.

An undertaking or scheme may be entered into where no physical work has begun and no contacts have been entered into for the work. The commencement date of a scheme or undertaking may vary and must depend upon an analysis of all of the circumstances: *Smith v Commissioner of Inland Revenue* (1987) 9 NZTC 6,045 (HC); and on appeal *Smith v Commissioner of Inland Revenue* [1987] 1 NZLR 727, (1987) 9 NZTC 6,118 (CA). An undertaking or scheme is a project or enterprise directed to an end result: *Smith v Commissioner of Inland Revenue* (1989) 11 NZTC 6,018 (CA).

The dictionary definition was accepted as being properly attributable to the word scheme, namely, “a plan design or programme of action, hence a plan of action devised in order to attain some end; a project; an enterprise”, *Wellington v Commissioner of Inland Revenue* (1981) 5 NZTC 61,101 (HC).

A taxpayer contended that profits derived from the sale of units had not involved an “undertaking or scheme” because:

(a) It never intended to develop town houses;
(b) The CIR had allowed as non-taxable the profits on the first two units and therefore should not seek to tax profits from the sale of the other two units;
(c) Operations occurred “haphazardly” and were not the result of any firm plan or undertaking, the whole enterprise was opportunistic rather than even speculative; and
(d) The company was forced into the situation of haphazardly completing the units in order to rid itself of an unwanted land investment.

In *TRA Case F6* (1983) 6 NZTC 59,591 the TRA, in finding that the activity was “quite clearly” an undertaking or scheme, cited a previously adopted meaning:

“A scheme presupposes some programme of action, a series of steps all directed to an end result. Similarly an undertaking is an enterprise directed to an end result.”

This view was taken in the case of *O’Toole v Commissioner of Inland Revenue* (1985) 7 NZTC 5,045 (HC), where it was noted that a bare subdivision of land did amount to a “scheme or undertaking”.

A profit motive is not essential. The word “development” does not include the construction of buildings. The paragraph cannot be read as “development into lots or division into lots”: *Dobson v Commissioner of Inland Revenue* (1987) 9 NZTC 6,025 (HC). See also *TRA Case K68* (1988) 10 NZTC 544.

The commencement date of the undertaking is generally deemed to be the first step that is taken of a reasonably definite nature and of a continuing series leading to the development or subdivision. This could be the initial preparation of a plan if the succeeding steps leading to the actual subdivision and sale follow on immediately. On the other hand, the mere preparation of a plan would not be regarded as constituting the commencement of the scheme if there was an appreciable delay between the preparation of the scheme and its eventual implementation.

In *Wellington v Commissioner of Inland Revenue* (1981) 5 NZTC 61,101 (HC), division work or development work must be taken to indicate different though possibly overlapping categories of work. Other types of professional work (eg fencing or planting), which necessarily precedes the legal separation of one part of the land from the other, is division work. The legal separation into lots of land includes submission for Council approval and registration with the Land Transfer Office and all the related surveying and engineering work.
This decision, by implication, disapproved of an earlier decision in TRA Case D24 (1979) 3 TRNZ 477 that procedural requirements such as the preparation and deposit of land transfer plans did not amount to “work” that is to be taken into account.

It then fell for a factual consideration as to whether the work was more than of a minor nature. Cost was considered as one such factor to consider. Although no singular piece of work was great, the combination of all those could not be seen to be work of a minor nature. The development and division work comprised surveying and engineering works and legal matters costing over $9,000. The land and buildings cost $12,000. The Judge concluded that a scheme costing approximately 75 per cent of the value of the projects could hardly be said to have been of a minor nature.

In TRA Case E41 (1982) 5 NZTC 70,140 the TRA followed the Wellington case and held on the facts that although the division work was not that extensive by comparison with subdivisional work in general, the combination of survey legal and fencing work was something more than of a minor nature.

In Woolston v Commissioner of Inland Revenue (1987) 9 NZTC 6,010 (HC) the taxpayers purchased a freehold property of a motel and land. Two years after acquisition the taxpayers tried selling the motel as a going concern. Lack of success led to an agent recommending the units be sold off separately under a cross-lease development. After depositing a cross-lease plan, separate units were sold. The CIR’s assessment of sale profits holding that the flats plan showed a division of land was confirmed.

In contrast, doubts were expressed that any of the following circumstances would constitute more than minor work:

(a) A plan prepared merely to bisect a rectangular plot;
(b) A plan prepared merely to create a street access by two boundary lines connected by an arc; and
(c) Preparation of a flats plan for two units, either by itself or in connection with plans for either paragraph (a) or (b) above.

In Dobson v Commissioner of Inland Revenue (1987) 9 NZTC 6,025 (HC), the fact that the demolition of existing houses was an essential feature of the development work carried out was found to be determinative of the action not being work of a minor nature.


The amount assessable is the full amount of the gains or profits derived from the sale of “that land”: Lowe v Commissioner of Inland Revenue (1981) 5 NZTC 61,006 (CA). In this case a taxpayer argued that the words “that land” referred to the land sold, so that if only one lot were sold, that lot could not be said to be developed or divided. The Court rejected this argument and stated the section recognises that subdivisional schemes run over two or more income years. Accordingly, assessability applies to parts of, or lots of land sold, so long as that land is the whole or part of a block on which the development or subdivisional work has been done.

Subdividing a block of flats into nine unit titles is not work of a minor nature: Costello v Commissioner of Inland Revenue (1993) 15 NZTC 10,285 (HC); Costello v Commissioner of Inland Revenue (1994) 16 NZTC 11,253 (CA) [see TIB vol 6:2 (August 1994) at 27].

The CIR has issued an interpretation guideline on what constitutes work of a minor nature [see TIB vol 17:1 (February 2005)]. For examples see TES 17 (July 2004) 245, 246, 247, 248.

880.50 Sale of land in scheme of development or subdivision [ss CB 13, DB 27]

Section CB 13 applies only to schemes or undertakings that are not taxable under any of ss CB 6 to CB 12 or CB 14. The provision targets any undertaking or scheme commencing at any time after the acquisition of the land where the profits or gains are derived from the scheme of development or subdivision. The scheme must involve significant work on earthworks, contouring, levelling, drainage, roading, kerbing, channelling or on any amenity, service or work customarily undertaken in major projects involving the development of land for commercial, industrial or residential purposes.
There are two views as to the application of s CB 13. One is that it applies only to subdivision or development work commenced more than 10 years following the acquisition of the land. The other is that it would apply where s CB 12 (development or division within 10 years of acquisition) would apply but for an exclusion from that provision (eg the exclusion for business premises or rental properties).

Profits or gains are assessable under s CB 13 only to the extent to which they are derived from the development or subdivisional undertaking or scheme, as the value of the land at the date of the commencement of the scheme is allowed as a deduction [s DB 27].

In Mee v Commissioner of Inland Revenue (1988) 10 NZTC 5,073 (HC), the taxpayer was required by the local authority to pay for roading, water, and sewerage work of $12,760. The taxpayer’s total expenditure (including the payment to the Council) was $16,204 for a 22-section subdivision. The High Court held the subdivision was carried out by the Council, it having the entire say as to when the work was done or indeed whether it should be done. The payment to the Council (in effect a reserve fund contribution) could not be taken into account as being “expenditure”. The relevant expenditure, quantified at $3,750, was not significant, being some two per cent of the block’s unsubdivided value. Accordingly, the profits were not assessable.

Once a scheme or undertaking has commenced, s CB 13 applies in that income year whether or not the scheme has been completed and whether the scheme is carried out on the whole or only part of the land to which the scheme relates. The Court of Appeal in Cross & Goulding v Commissioner of Inland Revenue [1987] 1 NZLR 498 (1987) 9 NZTC 6,101 (CA) considered the commencement date of an undertaking or scheme involving earthworks or division of land to be when some act is done for the purposes of its implementation upon which a date can be established for valuation purposes. Preparation of a scheme (ie the process of arriving at the formulation of the means of the objective) is not part of the scheme itself. Implementation commenced when a contract was let and work began with local body approval.

Applying the decision in Cross, the High Court in Smith v Commissioner of Inland Revenue (No 2) (1988) 10 NZTC 5,042 (HC) held “the first positive step or overt act” of carrying out a scheme to be a specified departure application. This was confirmed by the Court of Appeal in Smith v Commissioner of Inland Revenue (1989) 11 NZTC 6,018 (CA). Dobson v Commissioner of Inland Revenue (1987) 9 NZTC 6,025 (HC) was applied by the High Court in Smith, where it was held that not only does development work not necessarily entail physical work on the land but also there is also no requirement that there be evidence that the whole undertaking or scheme could immediately be brought to fruition. Undertakings or schemes often necessitate staged processes which are interdependent.

880.55 Subdivisions excluded [ss CB 17, CB 20, CB 21, CB 23]

Exclusions from the operation of s CB 13 are provided under the following two circumstances:

(a) Taxpayer’s residence; or
(b) Business premises;
(c) Investment land; and
(d) Farm land.

(1) Taxpayer’s residence [s CB 17]

The following two circumstances each provides an exclusion from the operation of s CB 13:

(a) The purpose of the development, division or improvement to provide a private residence for the taxpayer and any member of the taxpayer’s family living with the taxpayer;
(b) An area of land of not more than 4,500 square metres, which was occupied mainly as residential land for the taxpayer and a member of the taxpayer’s family, has been divided into two or more lots and it is one of those lots that has been disposed of.

(2) Business premise [s CB 20]

Section CB 13 does not apply where the purpose of the work is to create or effect a development, division, or improvement for use in the taxpayer’s business (not being the undertaking or scheme).
(3) **Investment land [s CB 23]**

Section CB 13 does not apply where the division, development, or improvement is for use in deriving from the land income from a lease, licence or easement, or the granting of a right to take profits from the land.

(4) **Farm land [s CB 21]**

Section CB 13 does not apply where all of the following tests are met:

(a) Land that was used or occupied by the taxpayer, taxpayer’s spouse [see 960.10, or both of them mainly for the purposes of a farming or agricultural business has been divided into lots;

(b) The lot that has been sold is one of those lots;

(c) The lot that has been sold is of such area and nature that it is capable of being worked as an economic farming or agricultural unit; and

(d) The land was disposed of mainly to be used in a farming or agricultural business.

Matters to be taken onto account when deciding whether the last of these criteria has been met are:

(a) Consideration for the disposal;

(b) Current land prices in that area;

(c) Terms of the disposal;

(d) Zoning or classification of the land; and

(e) Proximity of other land being used or developed for non-farming, non-agricultural purposes.

(5) **What is an economic unit?**

It is not necessary that the unit be capable of providing the sole support of the purchaser. Many such holdings are in fact operated on a part-time basis with the owner also being involved in another business or in employment. However, the property must be capable of providing sufficient income to cover all outgoings and also provide a reasonable return on capital and possibly labour.

In *Bruhns v Commissioner of Inland Revenue* (1988) 10 NZTC 5,033 (HC) the High Court held that land is capable of being worked as an economic unit when, having regard to its area and nature, it is capable of producing a profit in that it produces an excess of income over expenditure after taking into account the cost of working the unit, including the cost of any borrowed capital and of any labour required to work it. The Court held that the land in question was capable at the time of sale of being developed to form economic horticultural units, and that the proceeds of the sale were, therefore, exempt. On appeal the High Court decision was overturned and it was held the test must be demonstrated to be satisfied at time of sale when the land must then have the present capability of being worked as an economic unit: *Commissioner of Inland Revenue v Bruhns* (1989) 11 NZTC 6,075 (CA). Each of the lots in question required expenditure of at least nine times its sale price over at least seven years to make it into an economic agricultural unit. The Court of Appeal declined to comment upon whether it preferred the definition of “economic unit” in the High Court or the *O’Toole* decision, as the High Court had erred in an earlier step by departing from the statutory requirement that the land should have a capability of being worked as an economic unit at the time of sale.

In *O’Toole v Commissioner of Inland Revenue* (1985) 7 NZTC 5,045 (HC), the High Court said that an economic unit is one in which it is capable of making reasonable profits on a stable basis. To define it somewhat differently, a property which is capable of yielding a reasonable standard of living for the owner without him or her having to resort to secondary employment, and after making due return on the capital invested. In that case it was found that, of the 11 lots sold, only one could meet these tests. The Ministry of Agriculture and Fisheries advice was to the effect that, although it was marginal, that particular lot could probably be farmed as an economic unit.

The exemption was considered in *TRA Case E41* (1982) 5 NZTC 70,140, where the taxpayer carried on a farming business on a property of 279 acres and subdivided six lots out of a block of 277 acres. Three lots were disposed of which were subject to s 67 (as it was referred to at the time). The TRA held that the exemption applied. One lot was acquired as a horse breeding stud for a short period of time, a second as a mixed farm...
that was almost self-sufficient, and the third for grazing purposes. The blocks were large in comparison with other farms in the area and of excellent quality.

In TRA Case S90 [1996] 17 NZTC 7,565, a farming couple who subdivided their farm was taxed on the profits from the sale of two lots because neither lot was capable of being worked as an “economic unit”. The TRA commented:

(a) The figures put forward by the taxpayer would not provide both an adequate return on capital and an adequate return for labour; and

(b) It was relevant that neither purchaser farmed their lot on a full-time basis and that the land was not well suited to growing the pasture contemplated by the taxpayers’ expert witness.

For the purposes of the exemption in s CB 21, the CIR considers that the phrase “farming and agriculture” includes:

(a) Animal husbandry;
(b) Beekeeping;
(c) Dairy farming;
(d) Forestry;
(e) Fruit growing;
(f) Grain and seed growing;
(g) Market gardening;
(h) Poultry farming;
(i) Sharemilking;
(j) Tobacco growing;
(k) Vegetable growing.

Activities which are not considered by the CIR to be farming and agriculture are:

(a) Aerial top-dressing;
(b) Dealing in livestock;
(c) Leasing or bailing livestock by the bailor;
(d) Providing services to persons carrying on a farming or agricultural business (eg services provided by agricultural contractors and seed cleaners).

**880.60 Deduction for value of land — major subdivision or development**

[s DB 27]

Where income arises under s CB 13, the land is deemed to have been sold to an unrelated third party immediately before the commencement of the undertaking or scheme and immediately reacquired at market value [s DB 27].

The method of valuation and allocation of that value over the subdivision is important in determining the deduction available against the proceeds of the sale. The Courts have stated that a reasonable basis must be used. Thus, an arbitrary assessment would not be acceptable.

In many situations, especially involving subdivisions, a logical apportionment of the cost price could be particularly difficult. However, it is clear from the legislation that the proceeds of disposal are income and that a deduction is allowed for the value of the land at the commencement of the scheme. Therefore, a profit figure must be arrived at, notwithstanding the difficulties or the fact that the result may not be arrived at with precision.

In Lowe v Commissioner of Inland Revenue [1981] 5 NZTC 61,006 (CA) the Court of Appeal stated that profits are to be arrived at by ordinary commercial practice and generally accepted accounting principles. The CIR assessed profits on an averaging method that gave an average cost of $2,300 per section which was
deducted from the amount received upon sale to give the assessable profits. The taxpayers objected but the Court upheld the CIR’s assessment and accepted the method of arriving at the profit. The taxpayers further contended that the effect of the change in the value of money in the interval between the acquisition of the land and its sale in lots should be taken into account in calculating the taxable profits on the sale of the sections. The Court rejected this contention and firmly established that inflationary effects on the calculation of profit are to be disregarded in assessing the amount of profits.

Assessable profits must be evaluated on the basis of historical cost (i.e., dollars expended and dollars received). Current cost accounting is inapplicable: *Lowe v Commissioner of Inland Revenue* (1984) 6 NZTC 61,712 (PC).

The method of determining assessable profits or gains was considered in *Holdaway v Commissioner of Inland Revenue* (1985) 7 NZTC 5,104 (HC). The taxpayer sought to exclude from assessable profits factors such as inflation, zoning changes, provision of amenities to the area, and other factors which influenced value but were not directly attributable to carrying out the scheme or undertaking. The CIR successfully challenged this approach and profits were assessed on an historical cost basis.

Each case is dealt with having regard to its own facts. However, the CIR generally accepts the government valuation of the sections sold as being a reasonable basis. This may not always be practical. For example:

(a) Where the period of development is so protracted that some sections will be sold before the total costs of the development are known; or

(b) Where an apportionment on an area basis may not be appropriate because the cost of developing some sections is greater than others due to topographical features.

880.65 **Sale of land which has been rezoned** [ss CB 14]

A taxpayer’s income includes gains from land sold within 10 years of acquisition, where at least 20 per cent of the gains were due to one or more of the following factors (commonly referred to as betterment factors):

(a) The rules of an operative district plan under the Resource Management Act 1991 (RMA) or a change in those rules following acquisition of the land.

(b) The likelihood of such rules being imposed or changed.

(c) A consent granted in relation to the land under the RMA, or a decision of the Environment Court under the RMA, following acquisition of the land.

(d) The likelihood that such a consent will be granted or a decision made.

(e) The removal of any condition, obligation, restriction, prohibition, or covenant (including a designation or heritage order) in relation to the land following acquisition.

(f) The likelihood that such a condition, obligation, etc will be removed.

(g) An occurrence or change similar to paragraphs (a) to (f) above, or the likelihood of such an occurrence or change.

Such gains are assessable only if they are not assessable under any of ss CB 6 to CB 12.

In *Swan v Commissioner of Inland Revenue* (1979) 4 NZTC 61,515 (SC), the taxpayer purchased land and, shortly after completion of the contract of sale, applied for and obtained local authority consent to a specified departure to change the zoning from rural use to residential. It was held that the Court, in deciding whether a likelihood existed at the time of the sale of a change of zoning, is entitled to take account of matters occurring after the sale provided that they were relevant to the existence of a “likelihood” at the time. The meaning of the term “likelihood” was considered to be variable according to the context of its use; and in the context of the legislation it required something more than a bare possibility but something less than a probability. A “reasonable probability” was adopted by the Court for the purpose of the case. The Court observed that, where a property has zoning potential at the time of acquisition by the taxpayer, though to a lesser degree than at the time of its resale, it is the increase of that potential over the period that the land is held by the taxpayer that must be reflected in the gain of at least 20 per cent on resale.
In *TRA Case X9* (2005) 22 NZTC 12,123, the proceeds from the sale of the property were due to the granting of a resource consent for the subdivision, so were taxable under s CD 1(2)(e) of the ITA 1994 (now s CB 14).

Exclusions from the operation of s CB 14 are provided for the taxpayer’s residence [s CB 18] and for farmland [s CB 22, see 880.70].

### 880.70 Land exempted from the rezoning provisions [ss CB 18, CB 22]

Income from the sale of rezoned land is (under certain circumstances) assessable under s CB 14 [see 880.65]. However, two exceptions apply.

The first is s CB 18 which provides an exception where:

(a) The taxpayer (and/or spouse [see 960.10] acquired the land with the intention of using it as a residence; and

(b) It was disposed of as a residence for the purchaser.

The second is s CB 22 which provides an exception where:

(a) The taxpayer (and/or spouse) acquired the land with the intention of using it in a farming or agricultural business; and

(b) The land was disposed of mainly for use in a farming or agricultural business and the sale was due to circumstances or events (other than the rezoning) which arose after the land was acquired by the taxpayer [see Public ruling BR Pub 04/04 (expired 1 June 2004) in TIB vol 16:4 (May 2004) at 4-5].

In both cases, it is not necessary that the taxpayer used the land for its intended purpose, provided the requisite intention existed at the time of acquisition.

### 880.75 Tax relief from the rezoning provisions [s DB 28]

A deduction from the profits or gains which are assessed through the provisions of s CB 14 is allowed for the greater of an amount of $1,000 or of 10 per cent of the gain for every complete year the land was held.

**Example:**

Land costing $80,000 is sold (after being held for six years) for $200,000 and is taxable under the provisions of s CB 14. The taxable gain is $48,000 less the costs of holding the land. The $48,000 is arrived at as follows: ($120,000 less $72,000). The $72,000 reduction represents 10 per cent pa of $120,000 for six years.

### 880.77 Land used for landfill [s CB 8]

Owners of land that has been used as landfill are able to elect that the land be held on revenue account. All of the following conditions must be met in order for the election to be valid:

(a) The land is used as a landfill prior to its disposal;

(b) The land is not being used as a landfill at the time of disposal;

(c) The land is not disposed of to a person who is an associated person under subpart YB [see 70.20];

(d) An election is filed in respect of all landfill sites of the taxpayer;

(e) Any person associated with the taxpayer also makes an election in respect of land used as a landfill; and

(f) The elections are filed by 24 June 2006 or 12 months after the date on which the person acquires the land, whichever is later.

While the election results in any proceeds from the sale of the land will be assessable, the cost of the land will be deductible. In the likely event that the land is sold at a loss, that loss is able to be offset against other income.
880.80 **Inherited land**

In calculating the profit or gain on the disposal of land, the cost of the land is taken as the market value as at date of acquisition. Where land is inherited, so that there is no cost price, the profits or gains are calculated on the basis of deducting from the proceeds of the sale the value of the land at the time at which it was inherited. The passive acquisition of land is included in the word “acquired”: Halliwell v Commissioner of Inland Revenue (1991) 13 NZTC 8,197. If a property is bought, the purchase price fixes the cost and thus the figure to be deducted. However, if the property is received by gift or inheritance, it is the value of the property at the time of the gift or the inheritance that must be deducted: Curran v Federal Commissioner of Taxation 74 ATC 4296 (HCA).

880.85 **Capital gains are taxable**

Profits and gains which under ordinary taxation concepts are gains of a capital nature are taxable under s CB 6 to CB 15. This issue was specifically raised in the Court of Appeal case of Love v Commissioner of Inland Revenue (1981) 5 NZTC 61,006 (CA), where it was contended that s 67 of the ITA 1976 does not apply where land sales are nothing more than a realisation of a capital asset. The Court rejected this contention stating that the section specifically sets out to tax identified situations of land transactions and, if liability arose by virtue of that fact, the Courts have the duty to give effect to that legislation. Quite clearly the Legislature has intended to create a tax liability on profits traditionally known as capital and as such traditionally not taxable.

880.90 **Land is not trading stock** [ss EA 2, YA 1]

In calculating income in the normal course of events, land is not included as trading stock and is therefore not covered by the trading stock rules in subpart EB. However, expenditure on land acquired on revenue account is “revenue account property” and its cost cannot be deducted for tax purposes until the property is disposed of or ceases to exist [s EA 2(2)]. For example, if a land developer has acquired land for development and resale, the portion of the acquisition and development costs relating to any part of the land which is unsold at year end is unable to be taken as a deduction: Thornton Estates Ltd v Commissioner of Inland Revenue (1998) 18 NZTC 13,577 (CA).

880.95 **Land disposed of for less than market value** [s GC 1]

Where “trading stock” is disposed of at less than market value, is treated as having been sold at its market price on the date of disposition. The term “trading stock” in these circumstances includes any land the disposal of which would produce income under ss CB 6 to CB 15.

880.100 **Date when land acquired and date when sold**

Except when the land is transferred from an “associated person” (in which case the land is deemed to have been acquired by the transferee on the same date as the transferor acquired it), land is considered to have been acquired or sold for income tax purposes at the moment when the beneficial ownership passed, which is the date of execution of an enforceable agreement for sale and purchase. The question of when land is sold was addressed in Mills v Commissioner of Inland Revenue (1985) 7 NZTC 5,025 (HC) in which it was held that, for a sale of land to take place, there must be an unconditional agreement for sale as it is only then that the equitable estate passes. The Mills decision was applied in TRA Case K60 (1988) 10 NZTC 487.

880.105 **Land transferred to an associated person** [s CB 15]

When land is transferred between a transferor and a transferee who are associated persons, the transferee is deemed to have acquired it on the day on which it was acquired by the transferor.

Where:

(a) Any land is transferred to an associated person; and
(b) The transferee subsequently sells that land at a profit; and
(c) The amount derived from the disposition would have been income of the transferor if the transferor had retained and then disposed of the land,
the proceeds of the disposition are taxable in the hands of the transferee.

Example:
D Ltd is in the business of developing land into commercial estates. R Ltd owns a number of retail outlets throughout New Zealand. D Ltd and R Ltd are associated persons. R Ltd purchases from D Ltd a block of land which forms part of one of D Ltd’s commercial estates. R Ltd has a retail outlet erected on the land and commences to trade from the premises. D Ltd pays tax on the profit in the normal way. Twenty years later, R Ltd sells the land and building in order to acquire more modern premises. R Ltd will be taxable on any difference between the sale price and the amount that it paid for the property 20 years earlier. The exclusion for the sale of business premises will not apply, as it is the circumstances of D Ltd (not R Ltd), that are relevant. The disposal proceeds would have been income in the hands of D Ltd had D Ltd retained the land (rather than selling it to R Ltd) and had later sold it.

880.110 Meaning of acquired

The word “acquired” connotes some element of intent or positive action on the part of the person acquiring the property. Therefore, a person who is the passive acceptor of a gift of land cannot be said to have acquired the land with any purpose or intent, and the donee is free to dispose of the land without any tax implications. This does not apply where the land is transferred from an associated person. It appears from the Australian case of Tikva Investments Pty Ltd v Federal Commissioner of Taxation (1972) 3 ATR 458 (HCA) that a donee who accepts financial obligations along with the gift (as when liability is assumed for a mortgage back to the donor or to another person) cannot be said to be a passive acceptor of the gift, and would be regarded as a purchaser of the land rather than a donee.

880.115 Repossession of land sold under agreement for sale and purchase

Where a vendor sells under an agreement for sale and purchase and later rescinds the contract because of default by the purchaser, the property is not “acquired” by resuming possession: Cowan v Federal Commissioner of Taxation (1972) 3 ATR 474, 72 ATC 4121 (VSC).

880.120 Land acquired or disposed of with other property [s DB 29]

Where any land is acquired together with any other real or personal property, the cost of acquisition must be apportioned between that land and that other real or personal property.

880.125 Sale of property on extended terms

When land is sold, the long established general rule is that the earnings basis of assessment is appropriate for business income. Consequently, where a person is in the business of selling land, the price of the land should be included in the taxpayer’s income for the year in which the land is sold (ie when the contract becomes unconditional). Where the taxpayer is a private individual whose income is earned in the form of salary and wages, and in the case of some professionals, the cash basis may be more appropriate.

Where a vendor mortgage is granted, the accrual rules will need to be considered in relation to the mortgage asset.

880.130 Mortgagee sale

A sale or disposition is deemed to include a mortgagee sale made as a consequence of the default of a taxpayer under a mortgage.

880.135 Spreading of income derived when land bought by the Crown [s EI 8]

Where a taxpayer derives income from a disposal of land to the Crown (including a compulsory acquisition) written application can be made to the CIR to spread the profit over the income year of disposal and the following three years. Written application should be made by or on behalf of the taxpayer within 12 months after the end of the tax year in which the disposal takes place, or within a further period if the CIR agrees.

Where the income is spread over two or more income years, any deduction for the cost (or deemed cost) must be allocated over the same income years and in the same proportions.
Any apportionment may be cancelled by the CIR at any time, in which case the balance of income not then assessed becomes taxable in one sum in the income year immediately preceding the year in which the apportionment is cancelled.

Before granting the application, the CIR may require the taxpayer to lodge suitable security for the payment of the taxation which becomes payable over the period of the apportionment. The legislation does not mean that profits on dispositions of land to the Crown are taxable in all cases. It merely provides for a concession (by the spreading of the profit over a maximum period of four years) to those persons who would otherwise be taxable on the profit in one sum in the year of disposal.

880.140 Loss on sale of land

There is no specific provision for the deduction of losses on the sale of land against other income. In TRA Case H20 (1986) 8 NZTC 212, it was held that the taxpayer had purchased a property with the intention of sale and, therefore, the profits were assessable. The deductibility of a loss on sale was allowed because the CIR had not argued that the loss was a capital loss.

TRA Case H20 was cited with approval in TRA Case L41 (1989) 11 NZTC 1,256, but it was stated that the true test of deductibility is the character of the relevant loss. A doctor had purchased property adjacent to his rooms and intended to renovate it prior to its sale as a tenanted property to an investor. Obtaining tenants proved difficult and the property was sold semi-complete to a private company of which the doctor was the major shareholder. The substantial loss was held deductible, having been incurred in the course of endeavouring to gain income.

In TRA Case M109 (1990) 12 NZTC 2,690, the taxpayers sought to claim as a loss the expenditure on the purchase of land. The Court held that, although the expenditure had been incurred, it could not be treated as a loss because a loss had not transpired.
Leased Assets

Chapter 900

900.10 Overview of leased assets

Leases with financing characteristics are known as “finance leases” and taxed as a financial arrangement [see 900.15]. All leases that are not finance leases (commonly referred to as operating leases) are excepted financial arrangements and thus excluded from the financial arrangements rules [s EW 5(9)].

Advance rental payments for the hire of leased property as at balance date may be prepaid expenditure [see 1140 PREPAYMENTS]. However, specific provisions exist to ensure that advance rental payments under operating leases are spread over the term of the lease [900.35].

The taxation of hire purchase agreements has separate specific provisions [see 640 HIRE PURCHASE AGREEMENTS].

Leases entered into before 20 May 1999 are excepted financial arrangements and fall outside the financial arrangement rules. Leases entered into between 6 August 1982 and 19 June 1999 are classified for taxation purposes as either specified leases or non-specified leases. The definition of “specified leases” only applies to leases entered into before 20 May 1999 [see 900.45].

A “lease” [s YA 1] is a disposition that creates a leasehold estate and, in the rules applying to finance leases, specifically means an agreement under which a lessor transfers to a lessee, for the term of the lease, a personal property lease asset or the right to possess a personal property lease asset in consideration for a lease payment. A lease includes:

(a) A hire or bailment, and a sublease; or
(b) A licence to use intangible property.

A hire purchase agreement and an assignment of a hire purchase agreement are excluded from the definition of “lease”.

The CIR may treat two or more successive leases of the same lease asset to the same lessee (or to an associate of the lessee) as one lease.

A “personal property lease asset” is any personal property (other than livestock and bloodstock) that is subject to a lease [s YA 1].

900.15 Finance leases [ss FA 6, FA 7, FA 8]

The finance lease rules apply to leases entered into on or after 20 May 1999.
A “finance lease” is a lease of a personal property lease asset, entered into on or after 20 May 1999, that satisfies any one or more of the following conditions (a) to (c):

(a) At the time the person enters into the lease, the lease involves or is part of an arrangement that involves:
   (i) The transfer of the ownership of the asset to the lessee, or an associate of the lessee, during or at the end of the lease term;
   (ii) The lessee or an associate of the lessee having the option of acquiring the asset for an amount that is likely to be substantially lower than the asset’s market value on the date of acquisition; or
   (iii) A right of an associate of the lessee to acquire the asset, or a right of the lessor to require an associate of the lessee to acquire the asset, during the term of the lease under an arrangement that does not entitle the associate to receive all of the personal property lease payments that may fall due after the acquisition;

(b) At the time the person enters the lease, or from a later time, the lease has a lease term that is more than 75 per cent of the asset’s estimated useful life, as defined in s EE 63 [see 250.60];

(c) The person enters the lease on or after 20 June 2007 and the lease is, or is part of, an arrangement that, when the person enters the lease (or when a change in the terms of the arrangement changes the allocation or size of the risks and rewards incidental to ownership of the lease asset):
   (i) Involves the use of the asset outside New Zealand for all or most of the term of the lease; and
   (ii) Involves income of a person other than the lessor, arising from the use of the asset by any person, that is exempt income, or excluded income, or non-residents’ foreign sourced income; and
   (iii) Is a finance lease under NZIAS-17 for the lessor, or for a company that is in the same group of companies as the lessor and derives assessable income from the arrangement, or is an arrangement under which persons other than the lessor bear substantially all the risks and rewards incidental to ownership of the lease asset, determined as at the time the person enters the lease and taking into account later changes to the arrangement [s YA 1].

A finance lease is treated as a sale of the lease asset by the lessor to the lessee on the date that the lease starts. The lessor is treated as giving the loan to the lessee for the lease asset, and the lessee is treated as using the loan to buy the lease asset. The depreciation and financial arrangement rules apply to the recharacterised arrangement [s FA 6]. For the lessor, the amount of the loan (ie the consideration) is determined under s EW 32. For the lessee, amount of the loan is determined under ss EW 32 and EW 33 [s FA 7, see 470.90]. For the purposes of the depreciation rules, the lessee (not the lessor) is treated as the owner of the leased asset [s FA 8]. This means that the lessee can claim depreciation on the asset and the lessor cannot.

**900.20 Treatment when finance lease ends** [ss CC 11, CC 12, FA 9, FA 10]

(1) **Lesse acquires asset** [ss CC 11, FA 9]

When the lessee under a finance lease acquires the lease asset on or before the end of the lease term, the acquisition is treated as the same sale as occurred under s FA 6 [see 900.15], with the result that no further tax adjustment is required.

If the lessee under a finance lease, or a person who is associated with the lessee at the time of acquisition, acquires the lease asset and later disposes of it for more than the consideration they paid for it, the excess is income under s CC 11. The excess is income of the lessee in the income year in which the lessee or the associated person disposes of the asset. The excess is not income under s FA 9 if the consideration derived on the disposal is income under another provision of the ITA 2007.

(2) **Lessor acquires asset** [ss CC 12, FA 10]

If the lessee under a finance lease does not acquire the lease asset by the end of the lease term, the lessor is treated as having acquired it on that date at the asset’s guaranteed residual value. If there is no guaranteed
residual value, the consideration is treated as zero. For the purposes of s FA 10, the consideration is called the “notional sale price”.

The “guaranteed residual value” is the amount to which both of the following apply:

(a) It is equal to the value of the lease asset as agreed in the lease by the lessor and the lessee; and
(b) Its receipt by the lessor, on the expiry of the lease term, is asserted and guaranteed by the lessee [s YA 1].

When the lessor sells, assigns or leases the lease asset to another person under another finance lease after the end of the original lease term, the following rules apply:

(a) If the consideration is more than the notional sale price:
   (i) To the extent that it is paid by the lessor to the lessee under the original finance lease, the notional sale price is increased by the amount of the difference; and
   (ii) To the extent that it is not paid by the lessor to the lessee under the original finance lease, the difference is income of the lessor under s CC 12 in the income year in which the original lease term ends.

(b) If the consideration is less than the notional sale price, and the lessee is required to pay the deficit to the lessor, the notional sale price is reduced by that amount.

If the lease is terminated before the end of the lease term and the lessee does not acquire the lease asset, the lessor is treated as acquiring it for an amount calculated using the formula:

\[
\text{outstanding balance} - \text{release payment}
\]

Where:

“Outstanding balance” is the amount of the outstanding balance of the loan on the date the lease is terminated.

It includes the principal, interest and penalties that are owing by the lessee on the date of termination [s YA 1].

“Release payment” is the amount the lessee paid to be released from their obligations under the lease.

The provisions in s FA 10 override s EE 45, which determines consideration for purposes of a disposal under the depreciation rules.

**900.25 Adjustment when lease becomes finance lease [ss CH 6, DB 51B, FA 11]**

A lessor and a lessee must make an adjustment if either:

(a) The lease is a consecutive or a successive lease:
   (i) That is treated as one lease (see below);
   (ii) With a term that the lessor and lessee do not contemplate, at the start of the term, will be more than 75 per cent of the estimated useful life of the personal property lease asset; and
   (iii) With a term that is more than 75 per cent of the asset’s estimated useful life; or

(b) The lease is an operating lease that becomes a finance lease under para (c) of the definition of “finance lease” in s YA 1 [see 900.15].

Two or more consecutive or successive leases are treated by the CIR as one lease if the same personal property lease asset has been leased to the same lessee or an associated person under the consecutive or successive leases [s YA 1 definition of “lease”, paragraph (d)(v)].

The lessor and lessee must each calculate an adjustment for the lease and include the adjustment in their tax return for the income year in which the lease becomes a finance lease.

The adjustment is calculated for the period (from the start of the term of the lease to the end of the income year in which the lease becomes a finance lease) using the following formula:

\[
\text{finance income} - \text{finance expenditure} - \text{unadjusted income} + \text{unadjusted expenditure}
\]

Where:
“Finance income” is the income that the lessor or lessee would have derived under the lease if the lease were a finance lease for the period;
“Finance expenditure” is the expenditure that the lessor or lessee would have incurred under the lease if the lease were a finance lease for the period;
“Unadjusted income” is the income that the lessor or lessee actually derived under the lease;
“Unadjusted expenditure” is the expenditure that the lessor or lessee actually incurred under the lease.
A positive adjustment amount is income under s CH 6 in the income year in which the lease becomes a finance lease. A negative adjustment amount is a deduction under s DB 51B in the income year in which the lease becomes a finance lease.

**900.30 Adjustments for certain operating leases entered into before 20 June 2007 [ss CH 6, FA 11B]**

A lessor must make an adjustment if a lease is an operating lease that:

(a) Was entered into on or after 20 May 1999 and before 20 June 2007;
(b) Is an arrangement, or part of an arrangement that, on 20 June 2007, meets the requirements of paragraph (c)(i) to (iii) of the definition of “finance lease” [see 900.15];
(c) Has a lease term ending after the end of the income year in which 20 June 2007 falls (the “adjustment year”); and
(d) Does not meet the requirements of s FA 11(1) before the end of the income year after the adjustment year.

The lessor must adjust their income and expenditure calculated for the lease asset by including an adjustment in their return of income for the tax year corresponding to the income year after the adjustment year. The adjustment is calculated using the following formula:

\[
\text{total depreciation losses} / 6
\]

Where:

“Total depreciation losses” is the total amount of depreciation loss for the lease asset allowed to the lessor in the period from the start of the term of the lease to the end of the adjustment year.

The adjustment is income of the lessor under s CH 6 in the income year after the adjustment year. The ATV of the lease asset at the beginning of the income year after the adjustment year is the total of the adjustment and the ATV the lease asset would otherwise have had. For income years beginning after 20 June 2007 in which the lease is an operating lease, the depreciation loss allowed for the lease asset, other than on disposal, is five-sixths of the depreciation loss that would otherwise be allowed.

**900.35 Lessee’s deductions under an operating lease [s EJ 10]**

When a lease of personal property is not a finance lease or a specified lease, s EJ 10 applies to allocate the payments under the lease to the respective income years over the life of the lease. The allocation is made under the following formula:

\[
(\text{part of term} / \text{term of lease}) \times \text{total of payments}
\]

Where:

“Part of term” is that part of the lease term that falls within the income year;
“Term of lease” is defined in s YA 1, but is generally the lease term; and
“Total of payments” is the total of the personal property lease payments.

Hence, prepaid lease installments under leases that are not finance leases or specified leases are not deductible in the year incurred and must be spread over the term of the lease.
Example:
On 1 October 20X1 a taxpayer with a 31 March balance date entered into a lease agreement and paid a deposit of $20,000 with monthly payments thereafter of $1,000 over a period of five years so that total payments amounted to $80,000. The lease is not a finance or a specified lease. Using the formula in s EJ 10(3) the amount allocated to each income year is as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Formula</th>
<th>Amount allocated</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1-X2</td>
<td>$8,000</td>
<td></td>
</tr>
<tr>
<td>20X2-X3</td>
<td>$16,000</td>
<td></td>
</tr>
<tr>
<td>20X3-X4</td>
<td>$16,000</td>
<td></td>
</tr>
<tr>
<td>20X4-X5</td>
<td>$16,000</td>
<td></td>
</tr>
<tr>
<td>20X5-X6</td>
<td>$16,000</td>
<td></td>
</tr>
<tr>
<td>20X6-X7</td>
<td>$8,000</td>
<td></td>
</tr>
</tbody>
</table>

A non-specified lease of a vehicle was considered in TRA Case J67 (1987) 9 NZTC 1,399. The lessor was entitled to rental of $1,260 per month for 18 months and, irrespective of when the lease was terminated by the lessee, was also entitled to $26,190 reduced by the rent previously paid. Private usage of the vehicle was 20 per cent. The taxpayer in the 1984-1985 income year paid rental of $1,455 but claimed to deduct $26,190. The TRA held that although s BD 2 of the ITA 1994 [now s BD 2] may have allowed deduction of $26,190, s EO 2 of the ITA 1994 [now s EJ 10] allows a deduction of the $1,455 paid in the 1985 income year which was incurred in deriving gross income.

900.40 Leased assets purchased and later sold at profit [ss CG 7, FA 5]

If a taxpayer acquires an asset that the taxpayer had previously leased, rented, or hired, and then sells the asset for more than the amount paid by the taxpayer for its acquisition, the taxpayer must include in their income (under s CG 7) the lesser of the amount by which the consideration on disposal is more than:

(a) The sum of the payments made; or
(b) The total deductions previously allowed for the lease, rental, or hire payments.

This only applies if the consideration on disposal is not income of the lessee under another provision of the ITA 2007. The amount is included in income in the income year in which the asset is sold.

This provision applies only to plant, machinery, or other equipment, motor vehicles, and temporary buildings. The provision also applies when an associated person of the lessee acquires the asset (otherwise than under a relationship agreement) and then sells it at a profit. In this case the lesser of the excess and the total amount of the lessee’s deductions is treated as income of the lessee.

If the leased asset was disposed of together with other assets, the total consideration must be apportioned between the leased asset and the other assets so as to reflect their respective market values. The amount apportioned to the leased asset is treated as being its cost of acquisition or its sale price, as applicable.

If a leased asset is sold or disposed of without consideration or for less than its market value (other than under a relationship agreement), the asset is deemed to have been sold for its market value at the date of sale.

900.45 Specified leases and non-specified leases

The taxation treatment of a specified lease is regarded as a sale of the asset that is subject to the lease, with a loan from the lessor to the lessee.

A “specified lease” [s YA 1] is a lease of a personal property lease asset if any one or more of the following apply:

(a) The lease is entered into between 6 August 1982 and 19 May 1999 (inclusive), and the lease has a guaranteed residual value, or a term that is more than 36 consecutive months, or a term that is the economic life of the asset because the CIR considers that the asset has an economic life of less than 36 months, and

(i) The lessee becomes the owner of the asset at the end of the lease term;
(ii) The lessee has the option to purchase the asset at the end of the lease term at a price the CIR considers will be significantly lower than the market value of the asset at that time;

(iii) The total of all personal property lease payments and the guaranteed residual value is more than or equal to, or slightly less than, the cost of the asset; or

(iv) The lessor and the lessee agree that the lessee is liable for the payment of all, or nearly all, expenditure incurred for the costs of repair and maintenance of the asset and any other incidental costs arising during the lease term for the use of the asset;

(b) The lease is entered into between 6 August 1982 and 19 May 1999 (inclusive), and the lessee acquires ownership of the asset by any means, whether from the lessor or another person; or

(c) The lease is entered into between 28 October 1983 and 19 May 1999 (inclusive), and a person associated with the lessee acquires the asset.

A “personal property lease asset” is any personal property (other than livestock or bloodstock) that is subject to a lease [s YA 1].

The “guaranteed residual value” means an amount:

(a) That is equal to the value of a personal property lease asset as agreed in the lease by the lessor and the lessee; and

(b) The receipt of which by the lessor, at the end of the lease term, is guaranteed by the lessee [s YA 1].

Two or more consecutive leases (or successive leases which, in the opinion of the CIR ought to be regarded as consecutive leases) to the same lessee (or lessees who are associated persons) for the same lease asset shall be deemed to be one lease of that asset the term of which runs from the commencement of the first lease to the expiry of the last.

A “non-specified” lease means any lease other than a specified lease.

900.50 Taxation of specified leases [ss FZ 2, FZ 3, FZ 4]

On entering into a specified lease:

(a) The lessor is deemed (at the commencement of the lease term):

   (i) To sell the asset to the lessee at cost price (Inland Revenue may accept market price where cost price cannot be determined in the normal manner); and

   (ii) To advance the lessee an amount equal to the cost price (or market price if appropriate) of the asset.

(b) The lessee is deemed to have:

   (i) Incurred capital expenditure equal to the cost price of the leased asset; and

   (ii) Raised a loan to finance the purchase of the lease asset.

On the expiry of the lease term of a specified lease:

(a) Where the lessee does not purchase the lease asset then it is deemed to have been sold to the lessor:

   (i) At a GRV specified in the specified lease; or

   (ii) At nil where there is no GRV specified in the lease;

(b) If the asset is subsequently sold, assigned, or leased under a specified lease by the lessor to another person for a consideration different to the deemed sale price and an adjustment is made to the residual credit (if any) received by the lessee under the first lease agreement, then the deemed sale price is to be adjusted accordingly [s FZ 2].

On early termination or cancellation of a specified lease:

(a) The leased asset is deemed to be sold on the termination date to the lessor by the lessee at a value that equals the amount by which the outstanding balance of the loan, deemed to be advanced by the lessor to the lessee, exceeds any amounts payable by the lessee to the lessor for release from the
Lessee’s obligations under the lease. Where no such excess arises the lease asset is deemed to be sold for no consideration; or

(b) Where the consideration payable by the lessee to the lessor on termination exceeds the outstanding balance of any loan, that excess is deemed to be income derived by the lessor in the income year of termination.

Under s FZ 2(8), if a lessee (or an associated person of a lessee), purchases or acquires a leased asset and then subsequently sells it, any excess in consideration between sale and purchase is income to the lessee.

**900.55 Income of lessor under specified lease [s FZ 3]**

The income of a lessor from a specified lease is deemed to be interest. The sum of the lease payments and the GRV (if any) less the cost price of the asset is the amount of interest which is assessable over the full lease term. The assessable interest is deemed to be derived during the initial period and during each instalment period calculated either:

(a) On the outstanding balance in such a manner and rate that ensures that the total amount is equal to the sum of the lease payments and the GRV (if any), less the cost price of the lease asset; or

(b) By another method “commonly applied in commercial usage” which, in the opinion of the CIR, results in a fair allocation of amounts which equal the sum of the lease payments and the GRV (if any), less the cost price of the lease asset.

Depreciation may not be claimed as a deduction by a lessor (under specified lease) [s FZ 2(3)]. If the lessor is a non-resident, then the specified lease rules apply to override the rules in the withholding payments regulations (ie because of the deemed sale to the resident lessee), and also the interest derived under the specified lease will be subject to non-resident withholding tax and subject to the limits in any relevant DTA.

**900.60 Deduction to lessee under specified lease [s FZ 4]**

When the lease asset is used or available for use in deriving income, depreciation is allowed in accordance with the depreciation regime in Subpart EE [see 250 DEPRECIATION]. A deduction is not allowed for the lease of an asset which is solely for personal use.

The lessee is also allowed a deduction for the interest content of all instalments paid. The interest is calculated using one of the methods which the lessor is required to use when determining income under the specified lease. The lessee and the lessor do not have to use the same methods. One such method is the “Rule of 78” [see 900.65], which is an alternative to an actuarial method. The Rule of 78 method is not appropriate for specified leases involving large sums and when it may be anticipated that the lessee has sufficient expertise to apply an actuarial method.

**900.65 The Rule of 78**

The “Rule of 78” may be used as a means of allocating the interest attributable to specified leases to income years.

**Example:**

A lease agreement was entered into on 1 April 20X1 for a machine which is to be leased for a period of 36 months. The cost price of the machine is $100,000. Lease payments are $4,000 per month, and at the end of the lease on 31 March 20X4, the lessee may purchase the asset at a guaranteed residual value of $5,000. The lease is a specified lease.

When the lease commences, the lessor records a loan to the lessee for $100,000 and the lessee records a loan from the lessor. Over the lease term the total interest income is equal to the lease payments received plus guaranteed residual value less the cost of the asset:

\[ ($4,000 \times 36) + 5,000 - 100,000 = 49,000 \]

Interest of $49,000 is allocated to the three income years covered by the lease term on a basis which gives a fair and reasonable allocation. If the Rule of 78 was used the allocations would be:

<table>
<thead>
<tr>
<th>Year</th>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1-2X2</td>
<td>$49,000 × 366/666 = $26,927</td>
</tr>
<tr>
<td>20X2-3X3</td>
<td>$49,000 × 222/666 = $16,333</td>
</tr>
<tr>
<td>Lease Term</td>
<td>Principal</td>
</tr>
<tr>
<td>------------</td>
<td>-----------</td>
</tr>
<tr>
<td>20X3-X4</td>
<td>$49,000</td>
</tr>
</tbody>
</table>

The sum of the number of digits of the whole lease term over a period of 36 months is:

36 + 35 + 34 + 33 + …. + 1 = 666

In the year ended 31 March 20X2 the sum of the digits of months is:

36 + 35 + 34 + 33 +…. + 25 = 366

In the year ended 31 March 20X3 the sum of the digits of months is:

24 + 23 + 23 + 22 + …. + 13 = 222

In the year ended 31 March 20X4 the sum of the digits of months is:

12 + 11 + 10 + 9 + …. + 1 = 78
Chapter 910
Legal Expenses

910.10 Legal expenses — general position [ss DA 1, DB 5, DB 18]
The general question of deductibility of legal expenses is determined by s DA 1 requiring a nexus between the income-earning process and the expenditure. There are also specific provisions allowing a deduction for the costs of borrowing money used for the purpose of deriving gross income and for the costs of preparation, registration or renewal of leases of property. The deduction is not limited to legal expenses. While there is no section in the ITA 2007 which is specific to legal expenses, there are a number of cases which provide some guidance.

910.20 Lease agreements [s DB 18]
Legal expenses incurred during the income year for the preparation and registration of any lease of property used in deriving gross income, or in the renewal of any such lease, are deductible.
Provided there is a nexus between the expenditure and the income-earning process, legal and other costs of acquiring a lease by purchase and the cost of transfer of a lease would also be deductible.
Expenses incurred in the preparation and registration of easements. Payments made to the owner of the land for the granting of the easement are not deductible. Where expenditure is incurred in the period from 1 January 1999 to 31 March 2002, Public Ruling BR Pub 98/7 applies [see TIB vol 10:12 (December 1998) at 47-51]. This ruling has not been reissued, but an interpretation statement [see TIB vol 14:9 (September 2002) at 30-32], continues to apply for expenditure incurred after 31 March 2002.

910.25 Borrowing money [s DB 5]
Legal expenses incurred in borrowing money to be used by the taxpayer as capital in deriving assessable or excluded income are deductible.
The word “borrowing” contemplates the creation of a debt and the relationship of debtor and creditor. It does not contemplate establishing an equity (shares or capital) relationship.
Section DB 5 overrides the capital limitation but the other general limitations such as the inability to deduct private or domestic expenditure remain and the general permission in s DA 1 must still be satisfied.
The following legal expenses are within the scope of s DB 5 and are deductible if there is a nexus between the expenditure and the income-earning process:
(a) Expenses incurred by a company in raising money by the issue of debentures, including the cost of preparing and issuing prospectuses;
(b) Loan procuration fees;
(c) Expenses incurred in borrowing by way of mortgage even when the mortgage is raised contemporaneously with the purchase of property.
Expenses incurred on the discharge of a mortgage or in the repayment of a loan or debenture generally are not deductible. However, where legal expenses are incurred in the discharge of a mortgage or debenture under a scheme of financial reconstruction (ie an old mortgage or debenture is paid off and a new loan raised), the legal expenses incurred for the discharge of the old debt and for the new loan are allowable as a deduction.
The new lenders would require the discharge of the old encumbrance in order that their security would be a first mortgage and so the costs relating to the discharge are incurred in the borrowing of money. However, costs incurred in transferring an existing mortgage when land is purchased would not be deductible as it is an expense in the transfer of a mortgage encumbrance and not in actually borrowing money.

**910.30 Deductible legal expenses**

From 1 April 2009, a taxpayer whose legal expenses for the year do not exceed $10,000 is able to deduct those expenses in full, provided the general permission is satisfied, without the need to consider the capital limitation. To be eligible for this concession, the legal services must be legal services as defined in the Lawyers and Conveyancers Act 2006 and must be provided by a person who holds a practising certificate issued by the New Zealand Law Society or an Australian equivalent. Where the legal expenses for the year do exceed $10,000, both the general permission and the capital limitation must be considered.

The following legal expenses are deductible for tax purposes under the general permission [s DA 1]:

(a) Changes to the constitution of a company and the cost of appointing company directors.
(b) Breach of contract, where a trader defends an action for breach of contract arising out of the sale of goods.
(c) Breach of traffic or other regulations or other infringements of the law by employees. However, if the employer is also implicated in the illegal acts of the servants, or where the expenditure is not directly associated with the carrying on of the lawful business of the employer, the costs are not deductible: *Magna Alloys and Research Pty Ltd v Federal Commissioner of Taxation* (1978) 9 ATR 188 (NSWSC). Traffic fines or penalties are non-deductible, being of a private rather than business nature: *TRA Case K62* (1988) 10 NZTC 504.

In *TRA Case L15* (1989) 11 NZTC 1,113 a real estate agency manager failed in claiming a deduction for legal costs incurred in defending a driving charge for which he was ultimately convicted and disqualified from holding a driving licence. The expenditure was not incurred to preserve the taxpayer’s income-earning capacity and, in so far as the income would be increased by licence retention, he had failed to provide a basis for apportionment between private and work elements. Legal fees payable by an importing company for charges brought under the Trade and Industry and Customs Acts were held deductible: *Nicholas Nathan Ltd v Commissioner of Inland Revenue* (1989) 11 NZTC 6,213 (HC). It was held commercially necessary and prudent to take advice as to whether a breach of law had occurred and as to the best way to minimise penalties. A sufficient nexus was established between the carrying on of the taxpayer’s business and the legal expenses. Fines or penalties imposed by Courts for breaches of the law are non-deductible as a matter of public policy to prevent business law-breakers gaining a preference over others.

(d) Expenses incurred in applying under the Tenancy Act for the fixing of a fair rent for premises, the Trade Practices Act for inquiries into the taxpayer’s own position and the Commerce Act regarding inquiries into the taxpayer’s position.
(e) Appearing before Commissions and Tribunals (eg Commerce Commission, Licensing Control Commission or Price Tribunal). Defending one’s rights before any Commission for established licences are deductible. Costs incurred in defending applications by competitors are not deductible.
(f) Debt collection, including the costs of unsuccessful attempts at collection.
(g) Defending libel actions.

**Example:**

In *Cox v Commissioner of Inland Revenue* (1992) 14 NZTC 9,164 (HC) a chartered accountant who was a director in the collapse of a substantial merchant banking group of companies, was able to claim legal expense as a defendant in a damages claim by the liquidator of the merchant banker.

Legal expenses incurred in response to an offensive newspaper article to preserve the reputation of a local body councillor who was also a director of public and private companies were deductible as there was a sufficient nexus to the income-earning processes: *TRA Case M121* (1990) 15 TRNZ 231. See also *Herald and Weekly Times Ltd v Federal Commissioner of Taxation* (1932) 48 CLR 113 (HCA).
Expenses incurred by a university lecturer (who was also a part-time freelance journalist) in seeking legal advice for a comment by a Crown Minister who described his work as politically motivated was deductible even though no action was taken: TRA Case H38 (1986) 8 NZTC 334.

(h) Expenditure incurred in creating or amending superannuation schemes for employees. A superannuation fund is for the benefit of employees and, as such, is part of the wage structure mechanism.

(i) Legal costs for objections to land valuations for rating purposes or to the classification of land made by a local authority.

(j) Patents: registration, renewal of and defending existing patent rights.

(k) Reducing or avoiding a liability for expenditure which, if paid, would have been deductible.

(l) Removal of an obstacle to trading or safeguarding or preserving an existing business.

(m) Litigation expenses incurred in an attempt to have a service contract reinstated. In TRA Case W42 (2004) 21 NZTC 11,387, the taxpayers sought a deduction for legal expenses incurred in an attempt to have a service contract reinstated on the basis that they had been unfairly treated in relation to the contract process.

(n) Royalties, being expenses incurred in connection with any trade agreement fixing the royalties payable on each article assembled in New Zealand.

(o) Costs of preparation of sharemilking agreements.

(p) Costs of dealing with enquiries from Inland Revenue for current or past year assessments.

(q) Tax return preparation costs and legal fees, Court costs, witnesses fees and accounting costs, in contesting a tax assessment and in pursuing a challenge [s DB 3].

(r) Renewal of trademarks and the costs of defending existing trademarks. The cost of registering new trademarks is not deductible.

(s) Intellectual property. In TRA Case H35 (1986) 8 NZTC 312, legal fees incurred to defend an action brought against a former employee over intellectual property were held deductible because if the expenses had not been incurred he might not have been able to earn his existing income in his new position.

(t) Improving employment contract. In TRA Case H35 (1986) 8 NZTC 312, legal fees incurred to obtain better terms of a consultancy arrangement were deductible even if the ultimate goal sought was not achieved.

(u) Costs incurred in appearing before a professional disciplinary committee are deductible if related to a successful hearing where the taxpayer has been faced with the risks of being suspended from his practice: A v Commissioner of Inland Revenue (1985) 7 NZTC 5,074 (HC). A solicitor’s claim to deduct a fine imposed by a law society disciplinary committee was denied in Robinson v Commissioner of Inland Revenue [1965] NZLR 246 (SC). See the obiter comments in TRA Case K50 (1988) 10 NZTC 411, where the success of the hearing was considered immaterial.

### 910.40 Non-deductible legal expenses

The following legal expenses are not deductible for tax purposes as they fall outside the provisions of ss DA 1, DB 5 and DB 18:

(a) Acquiring capital assets (eg legal expenses incurred in acquiring a hotel licence). The acquisition of a licence to sell fermented liquors is the acquisition of a capital asset. However, the cost of raising money to buy an asset is deductible.

(b) Forming, registering, or liquidating a company.

(c) Increasing, reducing or altering the capital structure of a firm. Expenses aimed at altering or improving the capital structure of an organisation so as to obtain a permanent and enduring advantage are not deductible on the grounds that the expenditure is of a capital nature. A deduction for legal costs...
Legal Expenses

incurred in issuing debentures with a floating rate of interest, or in substitution for shares or in issuing convertible notes is also precluded.

(d) Expenses incurred in connection with the manner of distribution of income among shareholders. This would include such matters as disputes between various classes of shareholders as to their rights or regarding the method of appropriating the company’s profits after they were derived. A further example would be expenses incurred by preference shareholders regarding the payment of dividends out of profits instead of the appropriation of the profits to a reserve. Such expenses are not incurred in deriving income but in ascertaining its appropriation.

(e) Legal expenses of drawing up a partnership deed or trust deed.

(f) Protection of a capital asset. For example:

(i) In defending allegations of evasion of its obligations, a club incurred legal expenses in being represented before a commission appointed to investigate its affairs. The commission found that the allegations were without substance. It was held that the expense was incurred in order to protect the existence of the club and not to earn its income and consequently was not allowable as a deduction: IT Case No 488 (1942) 12 SATC 64.

(ii) Expenses incurred in the original registration of a trade-mark are capital and non-deductible; but those incurred in renewing registration are revenue and deductible: Case 78 (1955) 5 CTBR (NSW) 480.

(iii) Defending or prosecuting a case to have a business suppressed as a nuisance.

(iv) Legal costs and other expenditure incurred by a taxpayer operating in a licensed industry in appearing in defence of a licence.

(v) Expenditure incurred in opposing applications for licences by other firms wishing to carry on similar business in the district.

(vi) Appeals against modification of the terms of a vehicle authority.

(g) Legal expenses incurred in the sale of a business. The cost of valuing trading stock is however deductible.

(h) Litigation or unlawful acts. For example:

(i) Unlawful acts of a taxpayer or of the directors of a limited liability company. However, expenses incurred by a taxpayer arising from the negligence of an employee are deductible if the expenditure bears a direct relationship between its incurrence and deriving income (e.g., legal costs in connection with a breach of traffic regulations by an employee driver).

(ii) Defending a prosecution for a breach of the law in connection with the business, except in the case of breaches by employees. However, if the suit is successfully defended, no breach of the law has occurred and the expenses are then allowable.

(iii) Legal fees for advice to a company’s sole shareholder and director concerning an investigation by the CIR and the police were held non-deductible in TRA Case K8 (1988) 10 NZTC 149. The benefit of the advice was more private, relating to the shareholder’s personal and private reputation and less directly relating to his business reputation.

(iv) Legal costs incurred by a partnership in connection with criminal proceedings against one of the partners: Spofforth and Prince v Golder (Inspector of Taxes) [1945] 1 All ER 363 (KB).

(v) Promoting legislation, irrespective of whether the passing of such legislation will increase income or reduce expenditure.

(vi) In TRA Case U30 (2000) 19 NZTC 9,286 the TRA held that legal costs incurred in defending a criminal charge were not an allowable deduction because the expenditure was of a private and personal nature. Section DA 2(1) prohibits a deduction being allowed for expenditure having a private or domestic nature.

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(i) Expenses incurred in opposing an application by a lessee for a reduction in the rental payable, where the lease has more than one year to run. Where the lease has only one year to run, or is an annual lease, the expenses are deductible.

(j) Expenses incurred in deriving income from employment [s DA 2(4)].

(k) In TRA Case Z18 (2009) 24 NZTC 14,199, it was determined that legal expenses incurred in challenging the differential between the milk payouts to the taxpayers of a merged dairy co-operative were capital in nature and non-deductible.

**910.50 Legal expenses for negligence of taxpayer**

No deduction is allowed for a fine inflicted on a taxpayer: *Commissioners of Inland Revenue v EC Warnes and Co Ltd* (1919) 12 TC 227. However, a distinction must be drawn between a fine imposed in criminal or quasi-criminal proceedings and a fine imposed on a member by professional or trade organisations. Whether costs incurred in answering charges of unfair trade practices, or negligent or unskilful work (and any fine imposed by a trade or professional disciplinary body), are deductible depends on the facts of each case. As a general rule, they will not be deductible.

Losses arising out of the negligence or unlawful act of a taxpayer are, in some circumstances, deductible for tax purposes. In *Commissioner of Taxes v Webber* [1956] NZLR 552 (SC) a solicitor was negligent when he invested money for a client and the money was lost. He refunded the money to the client and, in his return of income, claimed a deduction on the basis that it was a loss exclusively incurred by him in the production of his income. The CIR refused to allow a deduction, contending that the loss was not exclusively incurred by the taxpayer in the production of income, but that it was capital expenditure incurred to protect the goodwill of the practice rather than the earned income. It was held that a loss was distinguishable from expenditure. Further, while in some New Zealand cases, notably *Ward and Co Ltd v Commissioner of Taxes* [1923] AC 145 (PC), and *Aspro Ltd v Commissioner of Taxes* [1932] AC 683 (PC), the purpose of the expenditure has been referred to as being a useful or appropriate test, in the present case the court was dealing with a loss which was incurred involuntarily. It was therefore meaningless to inquire as to the purpose of the loss. Where, in New Zealand, a claim is made for a loss as distinct from an expenditure, the inquiry must be simply whether the loss was incurred in the course of producing income. The loss must be fairly incidental to the carrying on of the business.

In *A v Commissioner of Inland Revenue* (1985) 7 NZTC 5,074 (HC), a medical practitioner was found guilty by the Medical Council of misconduct. He had previously been found guilty in the District Court and the Court of Appeal subsequently allowed the taxpayer’s appeal against sentence. The taxpayer claimed, as deductions from his income, legal fees incurred, fines imposed, and the costs awarded against him. The claim was disallowed by the CIR. The Court held that the claims for deduction of the fines and costs payable to the Medical Council were properly disallowed by the CIR because the expenditure was a penalty imposed on the taxpayer for dishonest activities. In order to claim a deduction for the legal costs incurred in the defence of the taxpayer, it must be established that they were incurred so that the taxpayer could go on earning his income. The legal expenses of defending the criminal charges were disallowed as there was insufficient evidence to enable any apportionment to be made between personal and business expenditure.

However, in TRA Case K50 (1988) 10 NZTC 411, a veterinarian’s entitlement to deduct legal expenses and an ordered contribution to disciplinary tribunal expenses was discussed. In obiter comment, the right to deduct expenses was upheld and the success or otherwise of the hearing was considered irrelevant.

On the other hand, there has never been any doubt that a liability incurred by a taxpayer through the negligence or unlawful acts of employees is deductible. In earning income, the employer must undertake the risk of liability for the wrongful acts of employees and, if the employer incurs expenditure to make good the loss, it may properly be claimed as a deduction in the year in which it is incurred.
Chapter 920

Look-through Companies

920.10 Overview

The look-through company (LTC) regime, contained in Subpart HB of the Act, applies for income years commencing on or after 1 April 2011. The regime effectively replaces the qualifying company (QC) and loss-attributing qualifying company (LAQC) regimes [see 1160]. Entry into the QC and LAQC regimes is not available for income years starting on or after 1 April 2011.

The company is transparent for tax purposes. Income, expenses, gains, losses, tax credits and rebates pass through to the shareholders and are taxed at the shareholders’ marginal tax rates. Some tax matters are dealt with at the company level such as GST, PAYE and other withholding taxes and matters related to the amalgamated companies regime [see 920.40].

As income tax is not payable at the company level, memorandum accounts under the imputation regime are not required.

920.15 Eligibility criteria

The look-through company (LTC) regime is available only where the entity meets the s YA 1 definition of “look-through company”. The following criteria apply:

(a) The entity is a body corporate or other entity that has a legal existence separate from that of its members, whether incorporated or created in New Zealand or elsewhere (para (a) of the definition of “company”);

(b) The entity is resident in New Zealand for tax purposes, including under the various double tax agreements;

(c) The entity has five or fewer “look-through counted owners” with relatives being counted as one;

(d) The entity is not a “flat-owning company”;

(e) All owners have only “look-through interests”; and

(f) A valid election has been received by the CIR.

The company must have only one class of shares. This requirement comes from the s YA 1 definition of “look-through interest” which requires all shares to carry the same voting rights as to company distributions, the company constitution, capital variations and director appointments, and also the same rights to receive company distributions and assets.

While the company must be resident in New Zealand for tax purposes, there is no requirement that the shareholders be New Zealand tax resident.
A “look-through owner” is defined in s YA 1 as:
(a) A natural person (other than a trustee) who has a look-through interest for the entity;
(b) A natural person who is a beneficiary of a trust and has, for the current income year or one of the
    previous three income years, derived beneficiary income that arose from an LTC;
(c) A trustee of a trust that:
    (i) Has either a look-through interest in an LTC or a beneficial interest in an LTC (direct or
        indirect); and
    (ii) Has not distributed as beneficiary income all of the income that arose from a direct or indirect
        beneficial interest in the entity for the current income year and all of the immediately prior
        three income years;
(d) A natural person shareholder of a company that has derived beneficiary income that arose (directly
    or indirectly) from an interest in an LTC for the current income year or one of the previous three
    income years.

Only natural persons, trustees or another look-through company are able to be shareholders. A company that
is not a look-through company is not able to be a shareholder in a look-through company.

920.20 Counting the shareholders
An LTC must have no more than five “look-through counted owners”. Where an LTC is a subsidiary of
another LTC, it is the owners of the parent LTC that are counted. In other words, the count is made based on
the ultimate shareholders of the company.

In counting the shareholders, relatives are counted as one person. Relatives are two persons who are connected
by being:
(a) Within the second degree of blood relationship;
(b) In a marriage, civil union or de facto relationship with each other;
(c) In a marriage, civil union, or de facto relationship with a person who is within the second degree of
    blood relationship to the other;
(d) An adopted child of the other;
(e) An adopted child of a person who is within the first degree of relationship to the other; or
(f) A trustee of a trust under which a relative has benefited or is eligible to benefit.

The following relationships are within two degrees:
(a) Spouses, parent and child (1st degree).
(b) Brothers and sisters, parent and stepchild, grandparent and grandchild (2nd degree).

The relationships that give rise to shareholders being counted as one survive death or dissolution of marriage.
Provided the company was an LTC, and those shareholders were counted as one at the time of death or
dissolution, they remain counted as one following the event.

(1) Natural person shareholders
The key to identifying the greatest number of shareholders that can be counted as one lies in finding a pivot
shareholder. Take the following family tree as an example:
Example

If all of these individuals were shareholders in an LTC, they would be counted as two shareholders. The first pivot is Josh. The second is Joe.

Josh’s grouping is:
1st degree: Mike and Sue (parents) Toni (spouse).
2nd degree: Alice (stepchild) John and Mary (grandparents).

If Josh was Alice’s adoptive father, rather than stepfather, their relationship would be first degree.

Joe’s grouping is:
1st degree: Anne (spouse) Cath (child).
Second degree: Jerry (son-in-law).

Joe is also within one degree of John and Mary (his parents) and within two degrees of Mike (his brother). Different groupings should be tried where minimising the number of “look-through counted owners” is desired.

If Josh and Toni were to divorce, and Toni remained a shareholder, she would still be counted as part of Josh’s grouping provided that the company was an LTC and both Josh and Toni were shareholders at the time at which the divorce occurred. Similarly, if Josh were to die, all of the members of his group would continue to be counted as a single shareholder subject to the same two tests.

(2) Trustee shareholders

Trusts must also be examined for the “look-through counted owner” test. The count is made on the basis of the number of beneficiaries that have received beneficiary income sourced from the LTC in the current income year or any of the three immediately prior income years. Where any income from the LTC has been retained in the trust (as trustee income) in the current income year or any of the immediately preceding income years, the trustees are also counted as one look-through beneficiary. Where a beneficiary of the trust is a company or a QC, the look-through is made to all of the natural persons who have a direct or indirect voting interest in the company.

Example

Uptown Co Ltd is an LTC. The various interests are as follows:
• All of the shares in Uptown Ltd are owned by the Upland Family Trust.
Look-through Companies

- The trustee of the trust is UpTrust Ltd.
- The shareholders of UpTrust Ltd are John and Mary Upland.
- The beneficiaries of the trust are the members of the Upland family (see above example and family tree).

Over a four-year period, the trust distributed beneficiary income and retained income within the trust as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Alice</th>
<th>Cath</th>
<th>Josh</th>
<th>Trustee (retained)</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1</td>
<td>Alice</td>
<td>Cath</td>
<td>Josh</td>
<td>Trustee</td>
</tr>
<tr>
<td>20X2</td>
<td>Alice</td>
<td>Cath</td>
<td>Josh</td>
<td>Trustee</td>
</tr>
<tr>
<td>20X3</td>
<td>Alice</td>
<td>Cath</td>
<td>Josh</td>
<td>Trustee</td>
</tr>
<tr>
<td>20X4</td>
<td>Alice</td>
<td>Cath</td>
<td>Josh</td>
<td>Trustee</td>
</tr>
</tbody>
</table>

The shareholder count in each of the years is as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1</td>
<td>3 Alice / Josh (2nd degree)</td>
</tr>
<tr>
<td>20X2</td>
<td>3 Alice / Josh / Mike (2nd degree through Josh)</td>
</tr>
<tr>
<td>20X3</td>
<td>3 Alice / Josh / Mike / Toni (1st and 2nd degree through Josh)</td>
</tr>
<tr>
<td>20X4</td>
<td>3 Alice / Josh / Mike / Toni (1st and 2nd degree through Josh)</td>
</tr>
</tbody>
</table>

920.25 Election to be an LTC [ss HB 1, HB 3]

Inclusion in the look-through company regime is voluntary. If all of the eligibility criteria are met, the company can elect to be an LTC. Entry is gained by way of a valid election filed with Inland Revenue.

A director of the company or other authorised agent of the company must sign and date the election and confirm that all owners have signed it. The election must state the income year for which it is to first take effect. All owners of the company are required to sign a notice of election. Where an owner is under the age of eighteen or does not have legal capacity, the person’s guardian or legal representative must sign for them. Where a person holds shares as nominee or bare trustee for the beneficial owner, that person may sign in accordance with the instructions of that beneficial owner. In addition to the notices signed by or on behalf of the owners, there must also be attached to the election evidence of unanimous agreement of the owners that the company become an LTC. In practice, if all of the shareholder election notices and the signed and dated notice by a director or authorised agent are filed with the CIR at the same time, this will provide sufficient evidence of unanimous agreement.

The election must be received by the CIR before the start of the income year specified in the notice. If the company has not previously been required to file a return of income (a newly incorporated or inactive company), the election must be received by the last day for filing the company’s return of income for the income year specified in the election. If the company is transitioning from the qualifying company regime, the election must be received by within six months of the start of the relevant transitional income year. A transitional income year is one of either the income year commencing 1 April 2011 or the income year commencing 1 April 2012.

The CIR has discretion to accept an election that is filed late or is invalid in some way (eg not all owners have signed it). However, this discretion can be exercised only in exceptional circumstances and provided the deficiency is rectified in the income year in which the election is first to take effect.

Once an election has been accepted, it remains in force until the company ceases to qualify to be an LTC or the election is revoked. A company will cease to qualify for LTC status if, at any time in an income year, it fails to meet the qualifying criteria.

920.30 Revoking an election to be an LTC [ss HB 1, HB 3]

Any owner of an LTC can revoke the election at any time. The revocation notice must be received by the CIR before the start of the income year in which it is to take effect. A copy of the revocation notice should
Look-through Companies

be sent to the director of the company so that all other owners can be informed of the revocation. Late notices of revocation can be accepted by the CIR but only where exceptional circumstances exist.

Where an owner files a revocation notice and then sells their shares in the company, the new owner or owners of those shares can reverse the revocation election. This action must occur before the start of the income year for which the revocation notice was to apply. Where this occurs, the original revocation notice is ignored.

Where revocation occurs, the company cannot again become an LTC for either of the following two income years.

920.35 Tax payable when electing to become an LTC [ss CB 32C, CX 63, HB 3]

When a company becomes an LTC, any loss carried forward balance is extinguished. The same applies where a company that is not an LTC amalgamates with a company that is an LTC [ss HB 3].

Where a company that is already in existence becomes an LTC, a tax calculation is required at that time. The same applies where a company that is not an LTC amalgamates with a company that is an LTC. The reason for the tax on entry is that the reserves of an LTC are not subject to tax on distribution. This tax on entry to the LTC regime does not apply to a company which is a qualifying company and is transitioning into the LTC rules.

The tax on entry into the regime arises in the form of income deemed to be derived by the owners of the LTC in the first year in which the company is an LTC. The income arises in proportion to each owner’s look-through interest in the company. The formula under which the calculation of deemed income is undertaken is:

\[ \text{dividends} + \text{balances} - \text{assessable income} - \frac{\text{balances}}{\text{tax rate}} - \text{exit exemption} \]

Where:

“Dividends” is the amount that would be taxable dividends of the company if:

(a) All of the company’s property other than cash was disposed of to an unrelated person at market value for cash;

(b) All of the company’s liabilities, other than income tax payable as a result of disposing of the property and meeting the liabilities, were satisfied at market value; and

(c) The company was liquidated and the remaining cash distributed to shareholders without imputation credits or FDP credits attached.

TaxNote: The amount that is a dividend on liquidation of a company does not include available subscribed capital [see 270.40] or the available capital distribution amount [see 270.40].

“Balances” is the sum of:

(a) The balance in the company’s imputation credit account;

(b) The balance in the company’s FDP account; and

(c) The amount of unpaid income tax for an earlier income year less refunds due for an earlier income year but not yet received.

“Assessable income” is the assessable income less allowable deductions arising from the deemed disposal and liquidation.

“Tax rate” is the company tax rate for the income year immediately before the company becomes an LTC or, in the case of an amalgamation, for the income year that includes the amalgamation date.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities and Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at bank</td>
<td>12,000</td>
</tr>
<tr>
<td>Fixed assets:</td>
<td>10,000</td>
</tr>
<tr>
<td>Mortgage</td>
<td>Share capital:</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th></th>
<th>Building</th>
<th>60,000</th>
<th>Subscribed in cash</th>
<th>30,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Less depreciation</td>
<td>5,000</td>
<td>Taxable bonus issue</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>55,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Plant</td>
<td>16,000</td>
<td>Non-taxable bonus issue</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>20,000</td>
<td></td>
<td>Revenue reserve</td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td>Realised capital gain</td>
<td>13,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>13,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>80,000</td>
<td></td>
<td>80,000</td>
<td></td>
</tr>
</tbody>
</table>

### Additional information:

- The market value of the building is $75,000.
- The market value of the plant is $10,000.
- A 10 per cent penalty applies if the mortgage is repaid early.
- The balance of the imputation account is $3,000.

Using the formula:

\[
\text{dividends} + \text{balances} - \text{assessable income} - \left(\frac{\text{balances}}{\text{tax rate}}\right) - \text{exit exemption}
\]

### Dividends

**Market value of property:**

<table>
<thead>
<tr>
<th></th>
<th>Building</th>
<th>75,000</th>
<th>Plant</th>
<th>10,000</th>
<th>Cash</th>
<th>12,000</th>
<th>97,000</th>
</tr>
</thead>
</table>

| Market value of liabilities: Mortgage 10,000 + 10 per cent | 11,000 |

**Net cash available for distribution** $86,000

Once the amount of cash available for distribution has been calculated, amounts that are not taxable as a dividend on liquidation of a company are deducted to arrive at the dividend amount:

**Net cash available** $86,000

**Less:**

Available subscribed capital

Subscribed shares $30,000 + taxable bonus issue $5,000 | 35,000 |

Available capital distribution amount (Capital reserve $10,000 + notional gain on building $15,000) | 25,000 |

**“Dividends”** = $16,000

**“Balances”** (imputation account) = $3,000

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**Assessable income:**

Depreciation recovered on building: \(5,000\)

Less loss on sale plant: \(-3,000\)

Less mortgage penalty: \(-1,000\)

"Assessable income" = \(920.40\)

**Tax rate** = 28 per cent

\[
\text{dividends + balances - assessable income - balances/tax rate - exit exemption} = \\
16,000 + 3,000 - 1,000 - 3,000/0.28 = \\
18,000 - 10,714 = \\
7,286
\]

This amount is then allocated to the owners in proportion to their shareholdings and is required to be included in their individual returns of income.

**Exit exemption**

Although not specifically stated in the Act, “exit exemption” does not apply where a company is entering the LTC regime for the first time. Where a company has been an LTC, exited the regime, and then enters it for a subsequent time, the balance of the formula, being the “exit exemption” must be calculated to ensure that no double taxation occurs.

Where a company enters the LTC regime for the second or subsequent time, the calculation demonstrated in the above example is carried out but the “exit exemption” is also required to be calculated.

“Exit exemption” is the amount arrived at using the formula in s CX 63(2). This formula calculates the amount to be treated as excluded income where a person derives a dividend from a company after it has ceased to be an LTC. The amount is excluded income because the underlying income that gave rise to the dividend has already been taxed in the hands of the shareholders of the LTC while it was in existence, or through the application of the entry tax calculation the first time that the company became an LTC. The formula is:

\[
\text{exit dividends - dividends after look-through}
\]

Where:

“Exit dividends” is the sum of all amounts that would be dividends if the company ceased to be an LTC and then immediately:

(a) Disposed all of all of its property to an unrelated person for cash at market value;

(b) Met all of its liabilities at market value (other than income tax payable as a result of disposing of the property and meeting the liabilities); and

(c) Were immediately liquidated with all remaining cash being distributed to shareholders without imputation credits or FTC credits.

“Dividends after look-through” is the total dividends paid by the company after it ceases to be an LTC and before it pays the dividend described in (c) of “exit dividends” (above).

**920.40 Tax treatment of net income of a look-through company**

[ss CB 32B, DV 22, GB 23(2), GB 24, GB 25B, GB 27, GB 28, GB 29, HB 1, HB 2]

The following matters continue to be dealt with at the company level:

- Goods and services tax (GST);
- Fringe benefit tax (FBT);
Look-through Companies

- PAYE;
- Resident withholding tax (RWT);
- Non-resident withholding tax (NRWT);
- Employer’s superannuation contribution tax (ESCT);
- Retirement scheme contribution tax (RSCT); and
- The amalgamated companies regime (Subpart FO).

The income and expenses of a look-through company are taxed in the hands of the owners of the company in proportion to their percentage interest in the company. Similarly, tax credits, rebates, gains and losses are dealt with at the owner level. Although this means that the LTC will not have taxable income, it is required to file a return of income specifying the amount of income and deductions allocated to each owner. The IR7 return is used for this purpose.

Where the percentage interest of the individual look-through owners changes during an income year, the items are allocated on the basis of each person’s average interest in the company. However, owners have the option of using the weighted average basis instead. These two options are based on the assumption that the company’s income and deductions arise evenly over the course of the income year.

A third option is to prepare accurate accrual accounts as at the date of a change in ownership interests. Income, expenses and other items are allocated for the first part of the year on the basis of these accounts. Separate accounts are prepared for the part of the income year following the change in ownership interests and these are used to allocate items for that period. Each owner will return the total of the two allocated amounts in their return of income for the year.

If the company has a market value circumstance during the income year, the effective interest of the owners is calculated as the average of their voting interest [see 170.20] and market value interest [see 170.25] for the income year.

Examples of the calculation of owners’ look-through interests under the various methods can be found in TIB vol 23:1 (February 2011) at 51 and 52.

(1) Working owners

Where an owner of an interest in an LTC is also employed by the company under a written contract of employment, and personally performs their duties under that contract, they are termed a “working owner”. PAYE applies to the salary paid to the working owner. The gross amount of the salary is an expense that is allocated to the owners under the look-through treatment of income and expenses. The amount is not income of the LTC for the look-through treatment. In other words, the salary is treated in the same manner as a salary paid to an arms-length employee.

This treatment is not available where the LTC is wholly or mainly engaged in investing money, holding or dealing in shares, securities, investments, or estates or interests in land.

(2) Livestock [s EC 12(4)]

For livestock valuation purposes, any livestock owned by an LTC is treated separately from any interest that an owner may have in livestock. Separate valuation elections are required and different valuation methods can be applied to each.

(3) Anti-avoidance provisions

(a) Owners under the age of 20 years [s GB 25B]

The CIR has the power to adjust the look-through interests and, as a consequence, the allocation of income and deductions where he considers that the standard methods result in an excessive allocation of income to a person under the age of 20 years. The provision applies only where two or more of the owners are relatives and one of them is under 20 years old. In exercising his discretion, the CIR may take into account the nature and extent of services rendered and the value of contributions made by way of capital, services or otherwise, and any other matters that the CIR considers relevant.
(b) **Excessive remuneration to relatives** [ss GB 23, GB 24]

Where an LTC employs a relative of an owner, the CIR can adjust the income allocations where he believes that the remuneration paid to that relative is excessive. The provision does not apply where all of the following conditions are met:

(i) A written employment contract has been entered into which is binding for a minimum of three years;
(ii) The relative is over the age of twenty years at the time of signing the contract; and
(iii) Each party to the contract has real and effective control of their entitlement to the remuneration.

(c) **Income from personal services - attribution of income rules** [ss GB 27, GB 28, GB 29]

The income attribution rules apply where an entity such as a company, trust or partnership (“the associated entity”) is interposed between a person providing personal services (“the working person”) and the user of those services (“the buyer”) [see 740.35]. For the purpose of applying these rules, an LTC is an “associated entity”.

### 920.45 Tax treatment of losses of a look-through company [ss HB 11, HB 12]

Net tax losses are dealt with in the same way as net income with each owner being allocated their proportionate share of the income and the expenses. As the income and expenses are allocated to the owners for inclusion in their respective returns of income, an LTC will not have any loss carry-forward.

There is an anti-avoidance provision that restricts the amount of an owner’s share of an LTC loss that can be offset against their other income for the year. The aim of the provision is to prevent an owner from claiming tax losses that exceed their economic loss. An owner cannot offset an LTC loss against other income to the extent to which it exceeds the amount calculated under the following formula:

\[
\text{investments} - \text{distributions} + \text{income} - \text{deductions} - \text{disallowed amount}
\]

Where:

(1) **Investments**

“Investments” is the sum of:

(a) The market value of the person’s shares at the time of acquisition;
(b) Amounts owed by the LTC to the person (eg shareholder current account credit balance or other loan); and
(c) The “secured amounts” not included in (b).

“Secured amounts” is the amount of any debt of the LTC that is guaranteed by the owner or an associated person of the owner. It is the least of the following:

(a) The amount of the secured debt. Where there is more than one guarantor, the amount of the debt is divided by the number of guarantors.
(b) The market value of the property against which the guarantee may be enforced. Again, this is apportioned where there is more than one guarantor.

(2) **Distributions**

“Distributions” is any amount paid by the LTC to the owner. It includes dividends, loans and shareholder current account debit balances. It does not include any salary or wages that the person has received in their capacity as a working owner.

(3) **Income**

“Income” includes all income and realised capital gains allocated to the person under the regime to the person in all income years (including the current income year) since the company became an LTC. It includes both exempt and excluded income. It also includes any assessable income that the person derived by contributing goods or services that the person has supplied to the company provided that the amount is not included in “investments” (see above). It excludes dividends paid by a foreign investment fund (FIF) to the extent to which the person had FIF income in the year in which the dividend was received.
(4) **Deductions**

“Deductions” is all expenditure or loss (including realised capital losses) in previous income years (excluding the current income year) in which the company was an LTC. It includes any deductions that the person has had in respect of goods and services that the person has supplied to the company. It excludes any amount for which the person was denied deduction under this provision.

(5) **Disallowed amount**

“Disallowed amount” is the total of “investments” (see above) made in the last 60 days of the income year if they have been distributed or reduced in the first 60 days of the following income year. As the wording is “if” and not “to the extent to which”, any reduction in the investment made within the timeframe will cause the entire amount to be included in “disallowed amount”. There is an exclusion from the treatment where the total amount reduced or distributed in the first 60 days of the following income year does not exceed $10,000.

A comprehensive example of the loss limitation rule calculation can be found in TIB vol 23:1 (February 2011) at 54.

To the extent to which the loss limitation rule results in a loss is not being able to be claimed by the person, it is carried forward and can be used in a subsequent income year subject again to the application of the loss limitation rule in that year.

Where a person ceases to have a look-through interest in the LTC (eg disposes of their shares in the company), any losses carried forward cannot be offset against other income. These losses are not extinguished. Instead, they continue to be carried forward and can be used in the normal way if and when the person again has an interest in the LTC.

If the company ceases to be an LTC, but continues in business, any losses carried forward by owners can only be offset against dividends that the person receives from the company. These losses cannot be offset against other income. If the company again becomes an LTC, any remaining losses are reactivated and can be used in the normal way.

There is relief from the loss limitation rules where a person disposes of their interest in the LTC. The loss is denied only to the extent to which it exceeds the amount that the person derives from the disposal of their interest in the LTC.

920.50 **Disposal of shares in an LTC** [ss FB 1, FB 10B, FC 1, HB 4, HB 5, HB 6, HB 7, HB 8, HB 9, HB 10]

For tax purposes, owners of an LTC are treated as holding anything that the LTC holds (eg the assets of the company and liability for debt). For this reason, when they sell shares in the company, they are deemed to have sold their share of the underlying property and tax consequences arise. However, certain thresholds apply that limit the requirement for shareholders to calculate and return this income.

(1) **Deemed disposals** [s HB 4]

The following result in an owner being deemed to have disposed of their interests in the LTC to a single third party for market value:

(a) Where the LTC ceases to exist through liquidation, court order or otherwise;

(b) To the extent to which the owner’s capital is reduced by a cancellation or buy-back by the LTC that is not pro rata for all owners.

These situations give rise to a deemed disposal of all of the underlying property and the tax consequences that flow from it.

(2) **General exemption** [s HB 5]

A $50,000 general exemption from the requirement to account for the tax consequences of the deemed sale of a person’s interest in the underlying assets of an LTC. The test for whether or not the exemption applies is carried out by way of applying the following formula:

\[
\text{disposal payment + previous payment - (gross tax value - liabilities) - $50,000}
\]
Where:
“Disposal payment” is the total consideration paid or payable to the exiting owner for their current owner’s interests in the company.

“Previous payments” is the total consideration paid or payable to the exiting owner for other disposals of some or all of their owners’ interests in the previous twelve months.

“Gross tax value” is the total of:
(a) The tax value of the person’s interests at the time of disposal (both current interests and any disposed of in the previous twelve months) to the extent to which those interests are revenue account property, depreciable property, or financial arrangements;
(b) The market value of the person’s interests at the time of disposal (both current interests and any disposed of in the previous twelve months) to the extent to which those interests do not fall within (a) above.

TaxNote: “Revenue account property” includes trading stock, emissions units, and other assets that would result in income for tax purposes if disposed of. The term does not include depreciable property or certain assets previously subject to a lease.

“Liabilities” is the exiting owner’s share of liabilities at the time of disposal of the interests (both current interests and any disposed of in the previous twelve months) calculated according to generally accepted accounting practice.

Where the result of applying the formula is less than zero, the tax effect is as follows:
(a) The amount received by the exiting owner for the disposal of their interests in the LTC is excluded income and no deduction is allowed in that income year or in later income years to the extent to which the person acquiring the interest (the “entering owner”) is allowed a deduction.
(b) The entering owner is denied any deduction for the amount paid to the exiting owner for the interests acquired and is instead treated as if they had acquired the interests at the time and for the value paid for them by the exiting owner. In other words, the entering owner steps into the shoes of the exiting owner in respect of those interests.

The effect of this provision is that, if the net value of the exiting owner’s interests is $50,000 or less, no assessable income or deduction arises in respect of the disposal of the interest in the LTC.

(3) Trading stock (excluding livestock) [s HB 6]
Where the turnover of the LTC for the income year in which a person disposes of an interest is $3 million or less, the exiting owner is not required to perform a revenue account adjustment in respect of the trading stock. Instead, the treatment is as follows:
(a) The amount of consideration payable to the exiting owner for their interest in trading stock is excluded income and no deduction is allowed in that income year or in later income years to the extent to which the person acquiring the interest (the “entering owner”) is allowed a deduction; and
(b) The entering owner is denied any deduction for the amount paid to the exiting owner for the trading stock and, instead, is treated as stepping into the shoes of the exiting owner in respect of it.

The effect of this treatment is that the exiting owner is not required to perform a revenue account adjustment in respect of the trading stock.

(4) Depreciable tangible property [s HB 7]
Where a person disposes of an interest in an LTC which owns depreciable tangible property with a total historical cost of $200,000 or less, the person is not required to account for depreciation recovery or loss on their share of those assets. Instead, the treatment is the same as that provided for trading stock (see above).

(5) Financial arrangements and certain excepted financial arrangements [s HB 8]
Where a person disposes of an interest in an LTC which owns:
(a) A financial arrangement; and/or
(b) An excepted financial arrangement that is an interest-free loan which is in New Zealand currency and repayable on demand, the person will not be required to perform a base price adjustment in respect of those items. The exemption is dependent on the following two factors:

(a) The financial arrangement or excepted financial arrangement was entered into for a purpose that was necessary and incidental to the business of the LTC; and

(b) The owners do not derive assessable income from a business of holding financial arrangements.

Provided the above requirements are met, the exiting owner is not required to perform a base price adjustment in respect of those underlying assets. Instead, as for trading stock and depreciable tangible assets (see above) the entering owner simply steps into the shoes of the exiting owner in respect of those assets.

TaxNote: The provision requires that “the owners do not derive assessable income from a business of holding financial arrangements”. Such income could arise by virtue of the LTC deriving it (due to the look-through nature of LTCs) or it could arise by virtue of the individual owners deriving it. However, as the section uses the plural “owners”, it is unclear what the effect would be of some (but not all) of the owners deriving such income, whether or not that includes the person who is disposing of their interest in the company. We have checked this point with Inland Revenue and they advise us that the policy intent is that it is only the assessable income from the particular LTC that is examined for this purpose. They agree that this is not reflected in the current drafting and that legislative amendment may be required.

(6) Short-term agreements for sale and purchase [s HB 9]

Exiting owners are not required to account for any tax effect of the sale of any underlying asset that is a short-term agreement for sale and purchase of property [see 470.30]. The part of the consideration for the disposal of the exiting owner’s interest in the LTC that relates to these assets is excluded income and, as with the other exemptions referred to above, the entering owner simply steps into the shoes of the exiting owner in respect of them.

(7) Livestock [s HB 10]

If the underlying assets of the LTC include livestock that is female breeding stock valued under either national standard cost scheme or the cost price method, the exiting owner has a choice as to how those items are dealt with.

One of the options is for the exiting owner to apply s EC 26B [see 1050.27] which results in the entering owner stepping into the shoes of the exiting owner is respect of that livestock. This is designed to reduce compliance costs for the LTC. Alternatively, the exiting owner can choose to treat the sale of their interest in that livestock as a normal disposal and account for the tax effect of that treatment.

TaxNote: The application of the s HB 5 formula for determining whether or not the $50,000 general exemption applies is used for that purpose only. This leaves a problem in that the term “consideration” is not defined for the purposes of the other exemptions outlined above which require the total consideration to be allocated to the various items and to any other item not covered by one of the exemptions. Logically, “consideration” should include the value of the proportion of liabilities of the company which are effectively taken over by the new owner of the shares. However, the wording of the provisions points to “consideration” being only the amount paid for the net value of the shares. Inland Revenue agrees that the provision is unclear and is looking into the matter. This lack of clarity prevents us from providing a worked example of the operation of the provisions.

920.55 Ceasing to be a look-through company [ss CD 43, CX 63, HB 4]

A company can cease to be an LTC either because the election has been revoked or because the company ceases to qualify as an LTC. Where cessation occurs but the company remains in existence, the normal tax rules for companies apply from that time forward.

Any retained earnings derived while the company was an LTC would have been taxed in the hands of the shareholders. Any retained earnings that existed in the company before it became an LTC would have been
subject to tax on entry into the regime. To ensure that these retained profits are not subject to tax in the hands of the shareholder for a second time when they are distributed as dividends, an ordering rule applies. This results in dividends being deemed to arise firstly from these retained earnings. The dividends are treated as excluded income in the hands of the recipients. It makes no difference whether the shareholders who receive the dividends are the same persons as those who were owners of the LTC.

The calculation of the amount of the dividends that can be distributed as excluded income of the recipient shareholders involves performing a notional liquidation similar to the one carried out on entry into the regime.

The formula for the calculation is:

\[
\text{exit dividends} - \text{dividends after look-through}
\]

Where:

1. **“Exit dividends”**
   - “Exit dividends” is the sum of the amounts that would be dividends if, immediately after ceasing to be an LTC:
     
     - (a) All of the company’s property other than cash was disposed of to an unrelated person at market value for cash;
     
     - (b) All of the company’s liabilities, other than income tax payable as a result of disposing of the property and meeting the liabilities, were satisfied at market value; and
     
     - (c) The company was liquidated and the remaining cash distributed to shareholders without imputation credits or FDP credits attached.

**TaxNote:** The amount that is a dividend on liquidation of a company does not include available subscribed capital [see 270.40] or the available capital distribution amount [see 270.40]

2. **“Dividends after look-through”**
   - “Dividends after look-through” is the total of all dividends paid by the company after it ceases to be an LTC.
   
   The “exit dividends” figure will remain constant. The “dividends after look-through” figure will increase each time a dividend is distributed. Once the formula results in a zero answer, all of the previously taxed retained earnings have been distributed and the normal rules for taxation of dividends apply to future distributions.
Chapter 940

Losses

940.10 Losses under the global-gross approach [ss BC 2, BC 3, BC 4]

In the context of taxation, the term “losses” has been used to refer to:

(a) A tax loss incurred from a specific transaction, eg losses arising from specific share transactions; and
(b) The overall tax loss incurred in a year when total deductions allowed in an income year exceed total assessable income for that year.

Generally, all amounts of assessable income are totalled and result in the taxpayer’s annual gross income for the year [s BC 2]. Similarly, all allowable deductions are totalled and result in the taxpayer’s annual total deduction for the income year [s BC 3]. The difference between the two amounts is either the person’s net income for the year, or the person’s net loss for the year [s BC 4(3)]. For some transactions, rather than applying the global-gross approach, the profit or loss arising is taken into account in calculating the net income for a tax year (eg under the provisions relating to financial arrangements) [see 470 FINANCIAL ARRANGEMENTS ].

An overall tax loss is now referred to as an available tax loss. The amount of available tax loss for a tax year is the amount by which annual total deductions exceed annual gross income. However, the continuity and commonality rules remain unaltered [see 940.20 and 940.30].

The requirement for a company seeking to carry forward a year’s loss to a later tax year is a 49 per cent minimum continuity. The minimum shareholding commonality for grouping of company losses is 66 per cent. This may be done either by payment or by election. The shareholder continuity for carry-forward of imputation credits, dividend withholding payment credits, and branch equivalent account tax credits is 66 per cent.

940.15 Loss rules for taxpayers generally [ss BC 4(4), IA 7, IA 4]

Generally, where a taxpayer’s annual total deductions exceed annual gross income for a tax year, the taxpayer has a net loss. However, the following net losses are treated differently because of special characteristics of the taxation provisions allowing those net losses:

(a) Losses incurred under the international tax regime [see 850 INTERNATIONAL TAX REGIME];
(b) Mining losses [see 980 MINING COMPANIES AND OPERATORS];
(c) Losses of loss attributing qualifying companies [see 1160 QUALIFYING COMPANIES];
(d) Policyholder net losses [see 800 INSURANCE ];
(e) Investment funds’ excess expenditure [see 370 EXEMPT AND EXCLUDED INCOME];
(f) Attributed CFC losses [see 850 INTERNATIONAL TAX REGIME];
(g) FIF net losses [see 850 INTERNATIONAL TAX REGIME];
(h) Petroleum net losses [see 980 MINING COMPANIES AND OPERATORS];
(i) Net losses of multi-rate PIEs [see 1130 PORTFOLIO INVESTMENT ENTITIES]; and
(j) Amounts remitted as a condition of a new start grant [see 430 FARMERS].

A taxpayer with a net loss for a tax year is entitled to carry that loss forward to the immediately succeeding tax year as an available tax loss. The taxpayer may then deduct it from, or offset against, the net income for that immediately succeeding tax year. The taxpayer may not offset net losses in excess of the net income for that succeeding tax year. However, where the available net loss exceeds the net income for that succeeding tax year, the taxpayer may carry forward that excess to the next succeeding tax year, and so on [s IA 4]. A limit of $10,000 per annum applies to losses incurred in certain specified activities before the 1991 income year [s IZ 1].

There is no time limit on when a net loss can be carried forward, but a net loss cannot be carried back to a previous year. Where net losses are incurred in two or more tax years and carried forward, they are deducted or offset in the order in which they arose [s IA 4].

940.18 Losses in a partnership [s HR 1]

Losses incurred in a partnership, except for special partnerships, are allocated to the partners who then include that share of the loss in their own personal income tax returns [s HR 1]. Additional rules apply to special partnerships [see 1050.70].

940.20 Losses carried forward — companies [s IA 5]

A company taxpayer (“the loss company”) that has incurred a net loss in an income year may only carry forward the whole or any part of that loss to any later income year where there is a group of persons:

(a) Whose aggregate “minimum voting interests” in the loss company in the period from the beginning of the year of loss to the end of the year of carry-forward (“the continuity period”) are equal to or greater than 49 per cent; and

(b) Whose aggregate “minimum market value interests” in the loss company in the continuity period are equal to or greater than 49 per cent in any case where at any time during the continuity period a market value circumstance exists for the loss company.

The minimum voting interest or the minimum market value interest, as the case may be, of any person in the loss company in the continuity period is equal to the lowest voting interest or market value interest in the loss company which that person has during the continuity period. See 170 COMPANIES for the measurement of minimum voting interests and minimum market value interests.

The shareholder continuity requirements for a group of persons are measured by looking at the continuity of minimum voting interests (and also minimum market value interests where a market value circumstance exists) during the period throughout which the continuity must be maintained. In calculating the lowest percentage, the lowest voting interest or market value interest for each person during the period is used.

Example 1:
If a shareholder’s voting interest in Loss Ltd during an income year is at various times 40 per cent, 20 per cent, 55 per cent, and 25 per cent, the lowest voting interest of the shareholder during that year is 20 per cent.
Example 2:  
A company with a standard balance date incurs a loss in the 20X1-X2 income year. The shareholding proportions equivalent to the voting or market value interest percentages are as shown below. The only changes occurred on 30 June 20X2.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Loss company shareholding</th>
<th>Lowest percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1 April 20X1</td>
<td>30 June 20X2</td>
</tr>
<tr>
<td>A</td>
<td>20%</td>
<td>60%</td>
</tr>
<tr>
<td>B</td>
<td>80%</td>
<td>10%</td>
</tr>
<tr>
<td>C</td>
<td>nil</td>
<td>30%</td>
</tr>
<tr>
<td></td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

The result is that the 49 per cent test is breached. The minimum continuity in the example is 30 per cent. The loss company cannot carry forward the loss incurred in the 20X1-X2 income year to the 20X2-X3 income year.

940.21 Part-year losses of companies when 49 per cent continuity not maintained for full year [s IP 3]

Part-year net losses may be carried forward (or grouped with other companies) where the continuity requirements are satisfied for only part of a continuity period, provided that the part-year net loss and the part of the net income against which the loss is to be offset are substantiated by adequate financial statements. These financial statements must sufficiently show the parts of the net loss and net income that are fairly attributable to that part of the income year in which the continuity requirements are satisfied, using the appropriate taxation rules as if each part-year were a full income year. An anti-avoidance provision exists. Inland Revenue has no provision to exercise discretion in the allocation of losses or profits.

Example 1:  
On 30 September 20X2 a standard balance date company incurred a change of shareholding of 52 per cent that breached the continuity requirement. In the 20X1-X2 income year it made a loss of $2 million. In the 20X2-X3 income year it made a loss of $1 million, but adequate accounts disclosed that the loss attributed to the period prior to 30 September 20X2 (when the continuity requirements were breached) was $600,000 and the loss attributed to the period after 30 September 20X2 was $400,000. The result is that the net loss incurred in the part-period ending 30 September 20X2 is not available to be carried forward, meaning that the amount of net loss able to be carried forward to the 20X3-X4 income year is restricted to that part of the loss incurred after 30 September (ie $400,000).

In a similar way, part-year losses may be carried forward to a subsequent income year and offset against part-year profits of the later income year where the continuity requirements (or the carry-forward provisions applicable to an earlier period) would not have prevented the carry forward. The carry-forward amounts must also be substantiated by adequate accounts.

Example 2:  
On 30 August 20X2 a standard balance date company incurred a change of shareholding of 52 per cent that breached the continuity requirement. In the 20X1-X2 income year it made a loss of $2 million. In the 20X2-X3 income year it made a profit of $1.5 million, but adequate accounts disclosed that the profit attributed to the period prior to 30 August 20X2 (when the continuity requirements were breached) was $700,000 and the profit attributed to the period after 30 August 20X2 was $800,000. The result is that the net loss offset is restricted to $700,000 in the 20X2-X3 income year, and the excess net loss is no longer available to carry forward to any later period, including the part-period after 31 August 20X2.

940.22 Company losses incurred in 1991-1992 and prior years [ss IZ 5, IZ 6]

Net losses incurred in the 1991-1992 and earlier income years may be carried forward and offset against the net income for 1992-1993 and later income years (or, where applicable, carried forward for offset against the net income of other companies within a group) if:

(a) The 40 per cent continuity test under s 188 before its repeal by the Income Tax Amendment Act (No 2) 1992 (including the lowest percentage interest modification from 8 pm on 30 July 1991) is met at all times from the beginning of the year of loss to the end of the year of offset; and
(b) From the first day of the 1992-1993 income year to the end of the year of offset, there is a group of persons, the total of whose lowest percentage of voting interests (and market value interests, where a market value circumstance exists) in the loss company, in each case, is at least 49 per cent.

The minimum voting interest or the minimum market value interest (as the case may be) of any person in the loss company in the continuity period is equal to the lowest voting interest or market value interest (as the case may be) in the loss company which that person has during the continuity period [s 1A 5].

An interpretation statement issued by the CIR is published in TIB vol 9:9 (September 1997) at 16-18.

**940.30 Offsetting losses within a group of companies** [ss IC 1, IC 2, IC 3, IC 4, IC 6, IC 13]

In broad terms, a company may only offset a net loss against the net income of another company if, at all times during the income year in which the loss was offset, both the loss company and the profit company are at least 66 per cent commonly owned (whether or not always during such period by the same group of persons) [ss IC 1, IC 2].

There is a dual test in order for two or more companies to be within a group of companies, relating to thresholds for voting interests and market value interests. Two or more companies can only be within a group of companies where, for those companies, there is at any time a group of persons with a total of at least 66 per cent of each person’s lowest percentage of voting interests. And if a market value circumstance exists, those companies must at any time also have a group of persons with a total of at least 66 per cent each person’s lowest percentage of common market value interests in each company [s IC 3].

Additional rules apply in relation to two or more companies, one of which is a multi-rate PIE. In order to form a group, the multi-rate PIE must own 100 per cent of the voting interests in the other companies and each company that is not a multi-rate PIE must be a land investment company [s IC 3(2B)].

Measuring whether a group exists may be done for any point in time, and for any income year or other period, as the case may be. Where the measurement is done for an income year or other period, the 66 per cent test must apply at all times during that period. The 66 per cent commonality rule must be met at all times from the commencement of the loss company’s income year in which the net loss was incurred to the end of the loss company’s income year in which the net loss was offset [s IC 6].

Where the percentage of interests held by a person in two or more companies differs, the lowest percentage interest that the person holds in either company is taken into account [s IC 3(3)].

---

**Example 1:**

Companies A to C are all standard balance date companies. There is no change in shareholding during the income year. A market value circumstance exists, in that a debenture with a floating rate of interest is issued (which was issued after 30 July 1991). Therefore, the shareholding proportions are equivalent to voting and market value interest percentages.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>A Ltd</th>
<th>B Ltd</th>
<th>C Ltd</th>
<th>Lowest common voting or market value interests</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>30%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>2</td>
<td>30%</td>
<td>40%</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>3</td>
<td>40%</td>
<td>40%</td>
<td>50%</td>
<td>40%</td>
</tr>
<tr>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>90%</td>
<td></td>
</tr>
</tbody>
</table>

The aggregate of lowest common voting or lowest market value interests is at least 66 per cent. Therefore, these three companies qualify as a group of companies for the income year.

**Example 2:**

Companies E to F are all standard balance date companies. There is no change in shareholding during the income year. A market value circumstance exists, in that a debenture with a floating rate of interest is issued (which was issued after 30 July 1991). Again, the shareholding proportions are equivalent to voting and market value interest percentages.
Losses

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>D Ltd</th>
<th>E Ltd</th>
<th>F Ltd</th>
<th>Lowest common voting or market value interests</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>60%</td>
<td>10%</td>
<td>60%</td>
<td>10%</td>
</tr>
<tr>
<td>2</td>
<td>10%</td>
<td>50%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>3</td>
<td>30%</td>
<td>40%</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td></td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>50%</td>
</tr>
</tbody>
</table>

The aggregate of the lowest common voting or market value interests is less than 66 per cent. Therefore, these three companies do not qualify as a group of companies for the income year. However, D Ltd and F Ltd on their own qualify as a group.

“Wholly-owned group of companies” means any two or more companies with 100 per cent common voting interests. Where a market value circumstance exists, 100 per cent common market value interest are also required [s IC 4].

Shares are held by a trustee for employees through the operation of any employee share purchase scheme are ignored in the calculation provided that the shares represent no more than three per cent of the voting interests or three per cent of the market value interests in the company where a market value circumstance exists [s IC 4].

An anti-avoidance provision exists to prevent companies from using the wholly-owned group provisions to avoid tax on certain transactions. For instance, an investment company could incorporate a wholly-owned subsidiary to hold certain shares on a long-term basis and thereby avoid paying tax on profits derived from the sale of those shares. Section CV 1 provides that any amount that a company derives that would not otherwise be income is treated as income if:

(a) The company is part of a wholly-owned group of companies for that income year; and

(b) Had the group of companies been a single company, the amount would have been income of that single company.

In order for a profit company to be allowed to offset a net loss from another company in the same group of companies, the following requirements must also be met [s IC 5]:

(a) Another company in the same group of companies (a loss company) must have either a net loss in the offset year or an available net loss (a net loss carried forward from a preceding income year) [ss IA 2, IC 1];

(b) The loss company either gives written notice that the whole or part of the loss be offset against the net income derived in the offset year by another company, or receives a payment from another company under an agreement providing for the other company (the profit company) to bear or share in the net loss. The offset may, therefore, be made by payment or written election [ss IC 5, IC 9];

(c) The profit company and the loss company must be in the same group of companies for the year when the loss company makes the offset. The profit company and the loss company must also be in the same group of companies for the year when the profit company makes the offset, where the year of offset for the profit company ends on a date later than the last day of the year of offset of the loss company [ss IC 5, IC 2(2), IC 6]. Where the loss or part loss was incurred by the loss company in any year following the 1981-1982 income year, the profit company must be in the same group of companies as the loss company in the preceding loss year of the loss company [s IZ 7]. Where the loss or part loss was incurred by the loss company in any year following the 1981-1982 income year, the profit company must be in the same group of companies as the loss company for all income years of the loss company (if any) falling between the loss year of the loss company and the year of offset of the loss company [s IZ 7];

(d) The loss company must at all times, from the year of loss to the year of offset be either incorporated in New Zealand or carrying on business in New Zealand through a fixed establishment in New Zealand. In addition, the loss company must not be either treated through a provision of a double tax agreement, as not being resident in New Zealand, or by the law of another tax jurisdiction, liable to income tax in that other tax jurisdiction by reason of domicile, residence, or place of incorporation...
Losses

The combined effect is that non-resident companies are able to offset their losses only to the extent of the losses of their New Zealand branches;

(e) Continuity of ownership must be maintained for the loss company for the year of offset. Where the year of offset of the profit company ends on a date later than the last day of the year of offset of the loss company, continuity of ownership must also be maintained through the year of offset of the profit company. Continuity of ownership is treated as being maintained for any company and any period where there is a group of persons:

(i) The aggregate of whose minimum voting interests in the company is equal to or greater than 49 per cent; and

(ii) The aggregate of whose minimum market value interests in the loss company is equal to or greater than 49 per cent in any case where at any time during the period a market value circumstance exists for the loss company.

The minimum voting interest or the minimum market value interest, as the case may be, of any person in the loss company in the continuity period is equal to the lowest voting interest or market value interest (as the case may be) in the loss company which that person has during the continuity period [ss IC 5, IC 2(1), IC 10(2)(a)];

(f) The amount to be offset against the profit company’s taxable income cannot exceed the net income of the profit company (after the offset of any losses carried forward), for that income year. It is not possible to transform a profit company into a loss company through these provisions [ss IC 5, IC 8]. For example, Profit Co has net income for the year of $10,000. It has losses carried forward from the previous income year of $2,000. The maximum loss offset is the lesser of $8,000 or the loss company’s net loss;

(g) Where the profit company makes a payment it must not exceed the amount of the loss. It is required to be made not later than the 31st day of March that, for the year of offset, is the latest date to which the time for the furnishing of the loss company’s return for that income year may be extended, or within such further time as the CIR may allow. It must not be otherwise taken into account in calculating the income of the loss company or the profit company. The loss company must give written notice to the CIR. It is not possible to transform a loss company into a profit company through these provisions [s IC 9]. For example, Loss Ltd, in the year of offset, has losses of $100,000, and Profit Ltd has profit of $150,000. The maximum loss offset in the year of offset is $100,000;

(h) The loss must not consist of any amounts as described in 940.15. The amount of the loss of the loss company is offset by the profit company against the net income for the year of offset. The offset reduces the available tax losses of the loss company in the same order in which those losses arose. Where any payment is made by the profit company to the loss company in consideration for the loss, the payment is not treated as a dividend paid by the profit company to the loss company.

Any election made is irrevocable. Notice may be given to the CIR by including it in return of income of the loss company. The notice must be filed no later than the 31st day of March that, for the loss company and the year of offset, is the latest date to which the time for the furnishing of the loss company’s return of income for the year of offset may be extended under s 37(5) of the TAA or within such further time as Inland Revenue may allow [s IC 9]. Where the provisions apply to non-standard balance date taxpayers, references to an income year includes a reference to a corresponding non-standard accounting year.

Standard practice statement SPS 05/12 sets out the CIR’s view of the circumstances under which group companies are able to offset losses [see TIB vol 18:1 (February 2006) at 5].

The 66 per cent threshold can be varied by Order in Council in respect of a company where either one or both of the following apply:

(a) The company is, or has been, carrying on a business wholly or mainly for the development of Niue;

(b) The company is, or has been, important to the development of Niue;

and, in both cases, the company has incurred expenditure in deriving income from that undertaking.
Any order will specify the name of the company or companies to which it applies [s IC 13].

**940.31 Part-year losses when 66 per cent commonality not maintained for full year** [ss IP 1, IP 2, IP 3, IP 4, IP 5, IP 6, IP 7]

A provision exists to offset a loss from a loss company against the profits of a profit company for periods comprising part of a year during which:

(a) The loss company maintains a continuity of shareholding; and

(b) A commonality of shareholding between loss and profit companies has been maintained.

The period during which the commonality of shareholding test is met is called the “group companies’ common span” [ss IP 1, IP 2].

Adequate accounts are required to have been prepared and furnished to Inland Revenue by both the profit and the loss companies. The accounts must detail sufficiently:

(a) In relation to the loss company, that part of the part-year loss of the loss company as is fairly attributable to the loss company commonality period; and

(b) In relation to the profit company, that part of the profit company’s part-year profit as is reasonably and fairly attributable to:

(i) The loss company commonality period where the year of offset of the profit company is co-extensive with the year of offset of the loss company; and

(ii) That part of the year of offset of the profit company which includes all or part of the loss company commonality period, in which the profit company and loss company are at all times members of the same group of companies and in which the continuity of ownership has been maintained for the loss company [s IP 6].

The loss company may, in a notice to Inland Revenue, elect to apply losses arising from the loss company to the profit company. Both the amount of the loss and the amount of the profit must be calculated for the “group companies’ common span”.

The rules effectively allow a loss (where a shareholder continuity of 49 per cent applies in the loss company) to be offset once only, and only against profits where there is a “group companies’ common span” with both the loss and offset companies in the same group.

**(1) Commonality lost part way through the income year** [ss IP 4, IP 5]

Where commonality is lost part way through the income year, the carried-forward and current-year losses may only be offset against the equivalent “group companies’ common span” pre-sale profit of companies in pre-sale group.

**Example 1:**

Loss Ltd and Vendor Profit Ltd have the same standard balance date. Loss Ltd satisfies the continuity of shareholding requirements (49 per cent threshold) from 1 April 20X1 until 31 March 20X3. Vendor Profit Ltd is formed on 1 April 20X2. For the period until 1 October 20X2 Loss Ltd and Vendor Profit Ltd have a group commonality, with shareholders having an aggregate of at least 66 per cent of common voting interests (and common market value interests where a market value circumstance exists). On 1 October 20X2, the two companies fail to satisfy the 66 per cent group commonality requirements.

Loss Ltd has net losses as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 April 20X1 to 31 March 20X2</td>
<td>$2 million</td>
</tr>
<tr>
<td>1 April 20X2 to 30 September 20X2</td>
<td>$500,000</td>
</tr>
<tr>
<td>1 October 20X2 to 31 March 20X3</td>
<td>$1 million</td>
</tr>
</tbody>
</table>

Vendor Profit Ltd determines its net income as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 April 20X2 to 30 September 20X2</td>
<td>$1.5 million</td>
</tr>
<tr>
<td>1 October 20X2 to 31 March 20X3</td>
<td>$2 million</td>
</tr>
</tbody>
</table>

In the “group companies’ common span” until 30 September 20X2, a loss offset from Loss Ltd is allowed against the net income of Vendor Profit Ltd. The offset is limited to $500,000, the amount of available tax loss arising in Loss Ltd during the “group span”.
companies’ common span”. The “group companies’ common span” is the period during which the companies are members of the same group for tax purposes.

Example 2:
Loss Ltd has a standard balance date and Maximum Profit Ltd has a late balance date of 30 June. Loss Ltd maintains its continuity of shareholding to at least 49 per cent from 1 April 20X1 all through the various periods. Maximum Profit Ltd is formed on 1 July 20X2 and for the period until 1 October 20X2 Loss Ltd and Maximum Profit Ltd have a group commonality, with shareholders having an aggregate of at least 66 per cent of common voting interests (and common market value interests where a market value circumstance exists). On 1 October 20X2, the two companies fail to satisfy the 66 per cent group commonality requirements.

Loss Ltd has net losses as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 April 20X2 to 30 June 20X2</td>
<td>$2 million</td>
</tr>
<tr>
<td>1 July 20X2 to 30 September 20X2</td>
<td>$800,000</td>
</tr>
<tr>
<td>1 October 20X2 to 31 March 20X3</td>
<td>$1 million</td>
</tr>
</tbody>
</table>

Maximum Profit Ltd determines its net income as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 July 20X2 to 30 September 20X2</td>
<td>$600,000</td>
</tr>
<tr>
<td>1 October 20X2 to 30 June 20X3</td>
<td>$3m</td>
</tr>
</tbody>
</table>

In the “group companies’ common span” until 30 September 20X2 a loss offset from Loss Ltd may be allowed against the net income of Maximum Profit Ltd. The loss offset is limited to $600,000, the amount of the net income of Maximum Profit Ltd during the “group companies’ common span”.

Example 3:
Big Loss Ltd has a standard balance date and Low Profit Ltd has an early balance date of 31 December. Big Loss Ltd maintains its continuity of shareholding at least 49 per cent from 1 April 20X1 all through the various periods. Low Profit Ltd is formed on 1 January 20X1 and for the period until 1 October 20X2 Big Loss Ltd and Low Profit Ltd have a group commonality, with shareholders having an aggregate of at least 66 per cent of common voting interests (and common market value interests where a market value circumstance exists). On 1 October 20X2, the two companies fail to satisfy the 66 per cent group commonality requirements.

Big Loss Ltd has net losses as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 April 20X1 to 31 December 20X1</td>
<td>$1.7m</td>
</tr>
<tr>
<td>1 January 20X2 to 31 March 20X2</td>
<td>$300,000</td>
</tr>
<tr>
<td>1 April 20X2 to 30 September 20X2</td>
<td>$500,000</td>
</tr>
<tr>
<td>1 October 20X2 to 31 March 20X3</td>
<td>$1 million</td>
</tr>
</tbody>
</table>

Low Profit Ltd determines its net income as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 January 20X2 to 30 September 20X2</td>
<td>$3m</td>
</tr>
<tr>
<td>1 October 20X2 to 31 December 20X3</td>
<td>$1 million</td>
</tr>
</tbody>
</table>

In the “group companies’ common span” until 30 September 20X2 a loss offset from Big Loss Ltd may be allowed against the net income of Low Profit Ltd. The loss offset is restricted to $800,000, the amount of available net loss that Big Loss Ltd has during the “group companies’ common span”.

(2) Commonality gained part way through the income year [ss IP 4, IP 5]

Subsequent to the loss of commonality (a post-sale situation) the qualifying carried forward losses and current part-year losses of a loss company may only be offset against the equivalent “group companies’ common span” post-sale profit of companies in a company group that exists after the sale of the shares.

Example 1:
Loss Ltd and Purchaser Profit Ltd have the same standard balance date. Loss Ltd maintains its continuity of shareholding to at least 49 per cent from 1 April 20X2 until 31 March 20X3. After 30 September 20X2 Loss Ltd and Purchaser Profit Ltd have a group commonality, with shareholders having an aggregate of at least 66 per cent of common voting interests (and common market value interests where a market value circumstance exists). Loss Ltd has made net losses as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 April 20X2 to 30 September 20X2</td>
<td>$400,000</td>
</tr>
</tbody>
</table>
Losses 1 October 20X2 to 31 March 20X3 $600,000

Purchaser Profit Ltd has made profits as follows:

1 April 20X2 to 30 September 20X2 $700,000
1 October 20X2 to 31 March 20X3 $500,000

In the “group companies’ common span” from 1 October 20X2 until 31 March 20X3 a loss offset from Loss Ltd may be allowed against the net income of Purchaser Profit Ltd. The offset is limited to $500,000, the amount of net income Purchaser Profit Ltd has during the “group companies’ common span”.

Example 2:

Loss Ltd has a standard balance date and High Profit Ltd has a later balance date of 30 June. Loss Ltd maintains its continuity of shareholding to at least 49 per cent from 1 April 20X2 all through the various periods. High Profit Ltd is incorporated on 1 July 20X2. After 30 September 20X2 Loss Ltd and High Profit Ltd have a group commonality, with shareholders having an aggregate of at least 66 per cent of common voting interests (and common market value interests where a market value circumstance exists). Loss Ltd has made net losses as follows:

1 April 20X2 to 30 September 20X2 $400,000
1 October 20X2 to 31 March 20X3 $600,000

High Profit Ltd has made profits as follows:

1 July 20X2 to 30 September 20X2 $200,000
1 October 20X2 to 30 June 20X3 $800,000

In the “group companies’ common span” from 1 October 20X2 a loss offset from Loss Ltd may be allowed against the net income of High Profit Ltd. The offset is limited to $600,000, the amount of net loss Loss Ltd has during the “group companies’ common span”.

Example 3:

Loss Ltd has a standard balance date and Mighty Profit Ltd has an earlier balance date of 31 December. Loss Ltd maintains its continuity of shareholding to at least 49 per cent from 1 April 20X2 all through the various periods. Loss Ltd and Mighty Profit Ltd have a group commonality, with shareholders having an aggregate of at least 66 per cent of common voting interests (and common market value interests where a market value circumstance exists). Loss Ltd has made net losses as follows:

1 April 20X2 to 30 September 20X2 $400,000
1 October 20X2 to 31 March 20X3 $600,000

Mighty Profit Ltd has made profits as follows:

1 January 20X2 to 30 September 20X2 $1.5 million
1 October 20X2 to 31 December 20X3 $200,000

In the “group companies’ common span” from 1 October 20X2 a loss offset from Loss Ltd may be allowed against the net income of Mighty Profit Ltd. The offset is limited to $200,000, the amount of net income Mighty Profit Ltd has during the “group companies’ common span”.

Standard practice statement SPS 05/12 sets out the CIR’s view of the circumstances under which group companies are able to offset part-year losses [see TIB vol 18:1 (February 2006) at 5].

940.32 Adequate accounts for losses grouping [s IP 6]

Where adequate accounts are required to substantiate a part-year result for the purposes of carry-forward of available net losses or offset within a group of companies, they must be prepared to the extent to which they are reasonable and fair, using the provisions of the ITA 2004 to that period as if it were an income year.

940.35 Loss carry-forward following a spin-out [s YC 13]

A spin-out occurs when shares in a subsidiary company are transferred to shareholders of the parent company. A spin-out may result in a change in shareholder continuity, preventing the carry forward of tax losses and tax credits in the subsidiary company. Special rules in s YC 13 apply to enable the carry forward of losses from spin-outs, which occur on or after 1 March 2002, subject to several conditions [see TIB vol 14:11 (November 2002) at 64-69].
Losses

Example:
ACo Ltd is held by shareholders none of which has a more than 10 per cent interest. ACo Ltd holds 100 per cent of the shares in BCo Ltd which, in turn, holds 100 per cent of the shares in CCo Ltd. CCo Ltd has losses available for carry-forward. ACo Ltd transfers the shares in BCo Ltd to ACo Ltd’s shareholders. Under the standard continuity rules, BCo Ltd’s shares (and therefore CCo Ltd’s shares) are deemed to be held by ACo Ltd on behalf of its small shareholders [s YC 11]. After the spin-out, the shares in CCo Ltd are deemed to be held by BCo Ltd which is no longer owned by ACo Ltd. There has been a 100 per cent change in the shareholding in CCo Ltd, resulting in the losses being forfeited, even though there has been no change in the economic ownership of the shares. Under s YC 13, BCo Ltd is deemed to have held before the spin-out a greater than 50 per cent voting interest (or market value interest if a market value circumstance exists) ignoring the look-through rules.

For the tax treatment of the Tower Ltd spin-out, see TIB vol 17:3 (April 2005) at 22.

940.40 Anti-avoidance and losses grouping [ss IC 11, GB 3, GB 4]
Anti-avoidance provisions exist for arrangements designed to defeat the legislation whereby Inland Revenue can treat the carry forward provisions as having not been met [s GB 3] or not allow a loss offset within a company group [s GB 4].

Example:
All the shares in a prospective loss company are transferred prior to the income year in which the company starts to make a loss, subject to an arrangement that the shares will be transferred back to the original owners after the end of the loss year. The anti-avoidance provision will also apply where it is the shares of the parent company of the prospective loss company that are acquired subject to a buy back arrangement.

Where a deduction has been claimed by more than one profit company for a qualifying loss from a loss company and the total amount of deduction claimed exceeds the actual loss, the deductions are reduced proportionately. However, the loss company may elect in writing within a period of six months (or such longer period as may be allowed) after Inland Revenue has given notice to the loss company of the excessive deductions by the profit companies to have a different reduction applying to the various profit companies. It cannot choose to have a greater reduction applying to a company which is no longer a member of the group of companies at the time of the election [s IC 11].

940.50 Special corporate entities and incorporated societies
A special corporate entity is deemed to have a paid-up capital and issued and allotted shares. The members or directors of such an entity, in their collective capacity as such, are deemed to hold all of the paid-up capital, issued and allotted shares, entitlement to profits, and voting power of the entity.

This means that special corporate entities are effectively exempt from the loss carry forward rules [s YC 5]. “Special corporate entity” means:
(a) Any public authority;
(b) Any local authority;
(c) Any State enterprise;
(d) Any Crown research institute;
(e) Any statutory producer board, other than a body that derives only exempt income;
(f) Any life insurance fund;
(g) An entity that has not issued shares and is engaged mainly in the business of providing life insurance or other insurance to the public;
(h) Any group investment fund (GIF);
(i) Any body incorporated under the Incorporated Societies Act 1908, for an income year in which the body on no day in the income year has shares on issue to the members of the body; or
(j) Any statutory body established by Act of Parliament (whether in New Zealand or elsewhere), where the CIR is satisfied to treat it as a special corporate entity.
Losses

While the provision extends to statutory bodies established by an Act of Parliament of a foreign jurisdiction, it should be noted that only New Zealand sourced losses are able to be offset against New Zealand sourced income. The main criteria the CIR would use in deciding whether it was appropriate to treat a statutory body as a special corporate entity, having regard to the terms of the statute by which a statutory body is established, is whether the body has any ultimate natural person shareholders with a beneficial interest. If it has, it is unlikely to be appropriate. A statutory body will need to submit a copy of its parent statute to Inland Revenue to allow a decision to be made as to whether it is appropriate to treat that body as a special corporate entity.

940.60 Losses sustained by foreign branch

A loss sustained by a foreign branch of a New Zealand enterprise, converted to the New Zealand currency equivalent, may be deducted from the other income derived by the New Zealand resident (whether from New Zealand or abroad), and if the loss exceeds the income the balance of the loss may be carried forward.

Example:

A New Zealand enterprise carries on business through a branch in Australia, where the annual total deductions exceed the annual gross income in the year ended 30 June 20X1 by A$10,000. The New Zealand currency equivalent of the annual total deductions and the annual gross income (adjusted for New Zealand tax law) is included in the calculation of net income of the enterprise for the year ended 31 March 20X1. If a net loss arises as a result, any balance of the net loss not offset against other companies in the same group may be carried forward. In Australia, the branch loss may be carried forward, and used against a subsequent year’s branch net income in Australia. In that subsequent year, New Zealand will include the branch’s annual gross income and annual total deductions in calculating the net income of the enterprise. The Act will also permit an available net loss to be utilised against that New Zealand net income. In addition, New Zealand will allow credit for the income tax paid in Australia (which will be arrived at on the basis of the net income of the branch after deducting the previous branch loss).

940.70 Use of losses to pay shortfall penalties [ss IA 3(1), IW 1]

A taxpayer can elect to use a net loss to pay a shortfall penalty. The taxpayer can do this if the net loss is available to be offset against the taxpayer’s net income in the tax year that the shortfall penalty is imposed — provided the taxpayer notifies the CIR of the election by the due date for payment of the penalty. The losses used may be either current year losses or losses carried forward from a previous year. A wholly-owned group of companies may elect to use a loss incurred by one company in the group to pay a shortfall penalty imposed on another company in the group.

The amount by which the penalty is reduced is the amount of the loss multiplied by the taxpayer’s lowest marginal tax rate [see 1110.195].
Chapter 950
Maori Authorities

950.10 Overview
The regime for the taxation of Maori authorities and their shareholders or beneficiaries is elective and is based on a company dividend imputation model.

Maori authorities that elect into the regime are taxed at the rate of 17.5 per cent. Tax paid by the Maori authority is credited to a “Maori authority credit account” and gives rise to “Maori authority credits”. These credits are able to be attached to “taxable distributions” paid to the members. Members are able to use these credits to offset their individual tax liabilities with unused credits being refunded if the member is resident in New Zealand for tax purposes. Resident withholding tax (RWT) is required to be deducted from taxable distributions to the extent that they are not fully credited.

There are also rules to govern the donations deduction available to Maori authorities [see 950.55].

950.15 Becoming a Maori authority [ss HF 2, HF 3]
Only the following persons are eligible to be a Maori authority:

(a) A company or trust that is established under the Te Ture Whenua Maori Act 1993 (Maori Land Act 1993);

(b) A company or trust that owns land that is subject to the Te Ture Whenua Maori Act 1993 (Maori Land Act 1993);

(c) A company that is established by a mandated iwi organisation to be an asset-holding company, as contemplated by s 12(1)(d) of the Maori Fisheries Act 2004;

(d) A company or trust that is recognised by Te Ohu Kai Moana Trustee Ltd as a mandated iwi organisation under s 13(1) of the Maori Fisheries Act 2004;

(e) The trustees of trusts that are established by Te Ohu Kai Moana Trustee Ltd as a mandated iwi organisation under ss 79 and 92 of the Maori Fisheries Act 2004;

(f) A company or trust that, under the deed of settlement and on behalf of Maori claimants, receives and manages assets that are transferred by the Crown as part of the settlement of a Treaty of Waitangi claim;

(g) The Maori trustee in the capacity as agent for an owner of land that is subject to the Te Ture Whenua Maori Act 1993 (Maori Land Act 1993);

(h) A Maori Trust Board as defined in s 2 of the Maori Trust Boards Act 1955;

(i) The Crown Forestry Rental Trust;
(j) Te Ohu Kai Moana Trustee Ltd, established under s 33 of the Maori Fisheries Act 2004; and
(k) Aotearoa Fisheries Ltd, established under s 60 of the Maori Fisheries Act 2004.

The eligibility to be a Maori authority does not include an individual or an unincorporated body other than a trust. Neither does it extend to entities owned by a Maori authority unless that entity is, itself, eligible to be a Maori authority.

A person who was a Maori authority (under the old rules), at the end of the 2004-2005 income year ceases to be a Maori authority unless the person was eligible at the beginning of the 2004-2005 income year to be a Maori authority (under the new rules), and before the end of the 2004-2005 income year, made an election to become a Maori authority.

A person who is eligible to become a Maori authority can elect to become one by filing an election. Under normal circumstances, the election will take effect from the first day of the income year in which the election is made. However, the person is able to nominate in the election that it take effect from the first day of the following income year.

Any election ceases to be effective if the Maori authority cancels the election or ceases to be eligible to be a Maori authority.

Eligible entities who choose not to file an election are taxed under the normal rules applying to entities of their type (eg the company or trust rules).

Entities that do not fall within the list of eligible entities, but who consider that they should be eligible, are able to request a legislative change to effect their inclusion in the regime.

950.20 Rules for entering, leaving and re-entering the regime [ss HF 9, HF 10]

The rules for entering the Maori authority regime are designed to ensure that no additional tax consequences arise.

Where a company or trust leaves and then re-enters the regime, it is treated as having realised and immediately reacquired its assets at market value. This ensures that any tax liability on such things as trading stock is accounted for at the company rate of tax. For depreciation purposes, assets are deemed to have been realised and reacquired at the lower of cost or market value, thus preventing an uplift in the depreciable value of the asset.

The tax treatment to be afforded on entry, leaving or re-entering the regime is set out below:

<table>
<thead>
<tr>
<th>Row</th>
<th>If</th>
<th>Becomes</th>
<th>Then</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Company</td>
<td>Maori authority</td>
<td>(a) The company ceases to be an imputation credit account (ICA) company and the rules relating to a company ceasing to be an ICA company apply; and (b) Retained earnings, accumulated profits and capital reserves are treated as an amount from which may be made a distribution that is not a taxable Maori authority distribution.</td>
</tr>
<tr>
<td>2</td>
<td>Trust</td>
<td>Maori authority</td>
<td>Trustee income is treated as an amount from which may be made a distribution that is not a taxable Maori authority distribution.</td>
</tr>
<tr>
<td>3</td>
<td>Maori authority</td>
<td>Company that is not a Maori authority</td>
<td>(a) The Maori authority may transfer a credit balance in the Maori authority credit account to the company’s ICA, and s OK 18 applies in respect of a debit balance in the Maori authority credit account; and</td>
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950.25

<table>
<thead>
<tr>
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<td>(b) Taxable income derived by the Maori authority in the 2003-2004 or an earlier income year is available subscribed capital.</td>
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<td>Taxable income derived by the Maori authority in the 2003-2004 or an earlier income year is treated as trustee income.</td>
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<th>If</th>
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<td>Company that is not a Maori authority</td>
<td>(a) market value calculations are required in accordance with s HF 10; and</td>
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<td>(b) the company must apply row 1.</td>
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<tr>
<td>6</td>
<td>Maori authority</td>
<td>Trust that is not a Maori authority</td>
<td>(a) market value calculations are required in accordance with s HF 10; and</td>
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<tr>
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<td></td>
<td></td>
<td>(b) the trust must apply row 2.</td>
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950.25 **Taxation of distributions from a Maori authority** [ss HF 4, HF 5, HF 6, HF 7, HF 8, CV 11, YA 1]

A “Maori authority distribution” occurs where there is a transfer of value from a Maori authority to a person and the cause of the transfer is the membership of the person in the Maori authority. It includes:

(a) Amounts advanced to a member to the extent to which the loan is not a genuine investment by the authority;
(b) A taxable bonus issue made by a Maori authority to a member;
(c) The disposal of property to a member to the extent to which the consideration is less than the market value of the property; and
(d) The acquisition of property from a member to the extent to which the consideration is more than the market value of the property.

Where a distribution has a Maori authority credit attached to it, the amount of the credit is included. A Maori authority distribution does not include the provision of services to a person by a Maori authority.

A “taxable Maori authority distribution” is a distribution from gross income of the Maori authority where that income was derived in the 2004-2005 or later income year and which was not exempt from tax in the hands of the Maori authority. The definition does not include such things as capital gains derived by the Maori authority or income earned by the authority prior to the 2004-2005 income year. The definition does include any taxable bonus issues made by the Maori authority to a member [s HF 7].

Where a Maori authority makes a “taxable Maori authority distribution”, the amount distributed is income of the member. Also included as gross income of the member are notional distributions made by a Maori authority that is a co-operative company. For Maori authorities which are co-operative companies, there is a specific exclusion from the definition of “taxable Maori authority distribution” for distributions made in respect of a notional distribution where the Maori authority has made a determination under s OB 82 that the distribution not be deductible.

Taxable Maori authority distributions are able to have Maori authority credits attached and, in most circumstances, are subject to deduction of resident withholding tax where they are not fully credited [see 950.60]. Members are able to use the attached credits to offset against their income tax liability. Excess credits are able to be refunded.

Non-taxable distributions are exempt from tax in the hands of the member.
950.30 Attaching Maori authority credits to distributions [ss HF 8, GB 42, OK 16, OK 17, OK 18, OK 19, OK 20, OK 21, OK 22, OK 23, OK 24]

A Maori authority is able to attach a Maori authority credit to a taxable Maori authority distribution. Where the Maori authority is a co-operative company, it may attach a Maori authority credit to a notional distribution in the same way that a non-Maori authority co-operative company can attach imputation credits to a notional distribution [see 670.90]. A Maori authority is also able to retrospectively attach Maori authority tax credits subject to the same criteria as the retrospective attachment of imputation credits [see 670.40].

Two allocation rules act to prevent Maori authority credits from being allocated on an inappropriate basis. They place restrictions on the base ratio of a distribution, i.e., the ratio of the amount of attached Maori authority credit to the amount of distribution paid (exclusive of credit).

The first allocation rule restricts the maximum amount of Maori authority credit that can be attached [s OK 19]. It requires that the base ratio of the distribution cannot exceed the following fraction:

\[
\frac{\text{tax rate}}{1 - \text{tax rate}}
\]

Where the “tax rate” is the basic rate of income tax for Maori authorities expressed as a percentage (currently 17.5 per cent).

This rule prevents credits from being attached to distributions in excess of the amount of tax that the Maori authority paid on the underlying income.

Example:

A Maori authority resolves to make a distribution of $805 and to attach a Maori authority tax credit. The maximum credit that can be attached is $175, calculated as 17.5/80.5 × $805, and doing so would result in a total distribution for tax purposes of $805 + $175 = $980 to the beneficiaries. However, the Maori authority could, instead, attach any amount of Maori authority tax credit less than $175.

Example:

A Maori authority resolves to make a distribution of $805 and to attach a Maori authority tax credit. The maximum credit that can be attached is $175, calculated as 17.5/80.5 × $805, and doing so would result in a total distribution for tax purposes of $805 + $175 = $980 to the beneficiaries. However, the Maori authority could, instead, attach any amount of Maori authority tax credit less than $175.

TaxNote: From the beginning of the 2011-12 income year to 31 March 2013, Maori Authorities have the option of attaching Maori Authority credits at the old rate of 19.5/80.5. This is the same transitional rule that applies to companies on the change in company tax rate. The transitional provision is designed to allow an opportunity for distributions of income which has been taxed at the higher rate. This will prevent credits being trapped in the Maori Authority.

The second allocation rule is aimed at preventing the “streaming” or unequal allocation of tax credits to different beneficiaries or different classes of beneficiary (not all of whom may be able to utilise the tax credits) during an imputation year. It establishes the first distribution for the imputation year as being the “benchmark distribution” and requires that the base ratio of every subsequent distribution made by the Maori authority during an imputation year must be the same as the ratio of the “benchmark distribution”, unless the Maori authority has supplied a ratio change declaration, in the prescribed form, to the CIR. In all cases, the imputation year runs from 1 April to 31 March [s OK 20].

The base ratio of a distribution paid subsequently to the benchmark distribution in an imputation year can differ from that of the benchmark dividend if:

1. The Maori authority declares in a ratio change declaration in the prescribed form, that the subsequent distribution is not being made as part of an arrangement to obtain a tax advantage, and provides such further information as the CIR may require; and
2. The ratio change declaration is delivered to the CIR before the date on which the subsequent distribution is made or such further time as the CIR may allow; and
3. The subsequent distribution is not paid as part of an arrangement to obtain a tax advantage [see 670.115 for a description of “tax advantage”].

Allocation debit [s OK 16]

If the second allocation rule is breached (ie where the required ratio change declaration is not filed, or the subsequent distribution paid is part of an arrangement to obtain a tax advantage) an allocation debit arises to the Maori authority credit account, calculated as follows:
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(\text{net distributions} \times \text{Maori authority credit ratio}) - \text{credits attached}

Where:

“Net distributions” is the total of all Maori authority distributions made by the Maori authority during the tax year, excluding the amount of any Maori authority credits attached to the distributions;

“Maori authority credit ratio” is the lesser of the ratio of the distribution with the greatest ratio of all Maori authority distributions made by the Maori authority during the imputation year; or the maximum allowable ratio (17.5 / 80.5); and

“Credits attached” is the total of all Maori authority credits attached to distributions made by the Maori authority during the imputation year.

The allocation debit is effectively the difference between the total amount of Maori authority credits actually attached to distributions made during the income year, and the total amount of Maori authority credits that would have been attached if all such distributions had ratios equal to the highest ratio (not exceeding 17.5 / 80.5) that was actually adopted.

Example:

A Maori authority makes the following distributions:

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
<th>Credits attached</th>
</tr>
</thead>
<tbody>
<tr>
<td>9 July</td>
<td>$10,000</td>
<td>$1,500</td>
</tr>
<tr>
<td>9 January</td>
<td>$10,000</td>
<td>$1,500</td>
</tr>
<tr>
<td>15 March</td>
<td>$20,000</td>
<td>$4,844</td>
</tr>
</tbody>
</table>

The ratio (4,844 / 20,000) of the subsequent 15 March distribution differs from that of the 9 July benchmark distribution. If no ratio change declaration was filed, the allocation debit arising would be: ($40,000 \times 0.2422) - $7,844 = $1,844.

The allocation debit to the Maori authority credit account arises at 31 March year end, so that it might cause a Maori authority credit account debit year-end balance to arise with consequential further income tax and penalties [see 1110.75].

Further tax payable [ss OK 21, OK 22, OK 23, OK 24]

A Maori authority is required to pay further income tax in the following circumstances:

(a) If there is a debit balance in the Maori authority credit account at the end of the imputation year. The amount of further tax payable is the amount needed to eliminate the debit balance. The amount is payable by 20 June following the end of the imputation year.

(b) If there is a debit balance in the Maori authority credit account immediately before the Maori authority ceases to be a Maori authority. The amount of further tax payable is the amount needed to eliminate the debit balance. The amount is payable no later than the last day on which the Maori authority is a Maori authority.

Any further income tax paid is able to be credited against any income tax liability or provisional tax liability for which the Maori authority becomes liable after the day on which the further income tax was paid.

A further anti-streaming rule, contained in s HF 8, provides that, where a distribution is made to members, all recipient members are treated as having received a proportionate share of taxable and non-taxable distributions.

Finally, s GB 42 contains further anti-streaming provisions where there has been an arrangement to obtain a tax advantage.

Maori authority credit accounts [ss OA 7, OB 1, OK 1, OK 2, OK 3, OK 4, OK 4B, OK 5, OK 6, OK 7, OK 8, OK 9, OK 10, OK 11, OK 12, OK 13, OK 14, OK 15, OK 16, OK 17, OK 18]

Every Maori authority is required to maintain a Maori authority credit account unless it either derives only exempt income (other than exempt dividends), or is prohibited by its constitution from making distributions...
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to members. Where a Maori authority is a company, it is not required to maintain an imputation credit account (ICA).

The opening balance of the Maori authority credit account is nil for the first tax year and, for every subsequent income year, it is the closing balance from the previous income year [s OA 7].

Credits to the “Maori authority credit account” (MACA) for an imputation year arise for:

(a) New Zealand income tax paid during the tax year by the company by way of provisional tax or terminal tax. The credit arises on the date the tax is paid [s OK 2]. However, no credit to the ICA arises for income tax that is:
   (i) Income tax in respect of the 2003-2004 or earlier income year;
   (ii) Income tax paid in respect of income derived before the date on which the Maori authority became a Maori authority;
   (iii) Income tax paid by way of offsetting any imputation credit attached to a dividend received;
   or
   (iv) Tax paid to eliminate a debit balance that exists in the MACA immediately before the Maori authority ceases to be a Maori authority;

(b) Overpaid provisional tax by another Maori authority that the other Maori authority has elected, under s RC 32, to allocate to the Maori authority to cover its underpaid provisional tax. The credit arises on the date tax is paid [s OK 3];

(c) Further income tax paid by the Maori authority under ss OK 21 or OK 22 to clear a 31 March debit balance in the MACA. The credit arises on the date the tax is paid [s OK 4];

(d) The amount of any tax credit for research and development expenditure. The credit arises on the day on which the Maori authority’s return of income is filed [s OK 4B];

(e) Maori authority credits attached to distributions derived by the Maori authority. The credit arises on the date that the distribution is made [s OK 5];

(f) Imputation credits attached to dividends paid to the Maori authority. The credit arises on the date on which the dividend is paid or, in the case of a taxable bonus issue of shares with imputation credits attached, the date that such a dividend is treated as having been paid [s OK 6];

(g) An amount previously debited to the MACA under s OK 17 in respect of an arrangement to obtain a tax advantage where it is subsequently established (eg by the CIR or by a Court), that there was no such arrangement. The credit arises on the same date that the previous debit arose [s OK 9].

Debits will arise to the MACA for:

(a) The amount of Maori authority credit attached to a distribution made by the Maori authority during the imputation year. The debit arises on the date the distribution is made [s OK 10];

(b) Any provisional tax that the Maori authority overpaid and then elects, under s RC 32, to allocate to another Maori authority to cover the latter Maori authority’s underpaid provisional tax. The debit arises on the date that notice in writing of the allocation is supplied to the CIR [s OK 11];

(c) Income tax refunded to the Maori authority, except to the extent that:
   (i) The tax paid was in respect of the 2003-2004 or earlier income year; or
   (ii) The tax paid was applied in satisfaction of an income tax liability for an income year during which the Maori authority did not maintain a MACA, or during only part of which the Maori authority maintained a MACA (in the latter case, the refund is apportioned on a daily basis);

The debit arises on the date the refund is paid [s OK 12];

(d) Overpaid income tax that the CIR applies to satisfy a tax liability of the company other than provisional tax or income tax (eg a GST liability), except to the extent that the amount applied is:
   (i) In respect of income tax paid for the 2003-2004 income year;
(ii) In respect of tax paid before the date on which a debit arises under para (f) below (breach of continuity); and

(iii) Not more than the amount of the debit that arises on that date (thus preventing double debiting);

The debit arises on the date the CIR applies the overpaid tax in satisfaction of the other liability [s OK 13];

(e) Any refund of dividend withholding payment (DWP) paid to the Maori authority at a time when it does not maintain a dividend withholding payment account (DWPA). The debit arises on the date the refund is paid [s OK 14];

(f) Any amount of a tax credit transferred for the payment of other taxes to the extent to which it does not result in a refund of income tax;

(g) Where the Maori authority is a company, any credits existing in the MACA (and not cancelled by a prior or subsequent debit), at any time where there is a breach of the 66 per cent shareholder continuity requirement [see 670.75]. The debit occurs at the time the breach of shareholder continuity occurs [s OK 15];

(h) The allocation debit that arises when the base ratio of a subsequent distribution differs from that of the benchmark distribution. The debit arises at the end of the imputation year for which the allocation debit arises [s OK 16];

(i) A further debit which may be imposed under the anti-avoidance provision s GB 42, where the CIR determines that there is an arrangement to obtain a tax advantage. The debit arises at the end of the imputation year in which the tax advantage arrangement occurred or commenced [s OK 17]; and

(i) Any credit balance in the MACA if the Maori authority ceases to be a Maori authority. The debit arises immediately before the Maori authority ceases to be a Maori authority, so that any credit balance in the MACA is extinguished at that time [s OK 18].

If the CIR considers that a credit or debit in the Maori authority’s Maori authority credit account is incorrectly recorded or has failed to be recorded, the CIR is required to determine the correct debit or credit amount and the date on which it should be recorded. As soon as convenient following the making of the determination, the CIR must give notice of the determination that has been made. Unless the Maori authority establishes in proceedings that the CIR is wrong, the account must be corrected in accordance with the determination.

950.40 Maori authorities that are companies [s HF 3]

Where a Maori authority is a company, the general rules applying to loss grouping, shareholder continuity, amalgamations, consolidations and co-operative companies apply unless specifically over-ridden.

A Maori authority may only:

(a) Offset losses against the income of another Maori authority;

(b) Amalgamate with another Maori authority whose legal form is that of a company;

(c) Be part of a consolidated group comprised of Maori authorities only;

(d) Be a co-operative company if all of the shareholders are Maori authorities.

These rules are designed to ensure that companies not eligible to be Maori authorities are prevented from obtaining unintended tax advantages.

950.45 Limits on refunds of income tax [ss RM 22, RM 23]

The maximum amount of any tax that is able to be refunded to a Maori authority is the amount of the credit balance in its Maori authority credit account as at the previous 31 March. Any excess that is not refunded may be offset against a future income tax liability. Where a Maori authority ceases to be a Maori authority, the maximum amount of tax that can be refunded is the amount of the debit that arose at the time at which it ceased to be a Maori authority.
950.50  Donations deduction for Maori authorities [s DV 12]

A deduction is available to Maori authorities for donations to a Maori association and to “donee organisations”. The maximum level of donation is the total amount of the authority’s net income (before deduction of donations). Prior to the 2008-2009 year, the maximum level of donation was five per cent of the net income.

To be a “donee organisation”, an organisation must have been established for charitable, benevolent, philanthropic or cultural purposes within New Zealand or must specifically be listed in s LD 3(2) or sch 32.

950.55  Charitable purposes [s YA 1]

In order for the purpose of a trust, society or institution to be a charitable purpose, it is necessary that the “public benefit” requirement be met. However, the fact that the beneficiaries of the organisation are related by blood to a named person does not, of itself, preclude the public benefit test from being met [see 150.10].

In certain circumstances a marae can have a charitable purpose. Where this is the case, the entity that administers the marae may be exempt from tax under ss CW 41 and CW 42 [see 150.10] and also qualify for tax credits and deductions under ss LD 1 and DB 41 [see 1395.75 and 300.20].

A trust, society or institution that administers a marae that is situated on a Maori reservation qualifies for an exemption only if it uses its funds solely for:

(a) Charitable purposes;
(b) Administration and maintenance or improvements to the marae’s physical structure.

Maori reservation is defined to be an area of land that is set aside for specific purposes, such as a marae, in accordance with the process set out in s 338 of the Te Ture Whenua Maori 1993 (Maori Land Act 1993).

Where an entity administers a marae that is not situated on a Maori reservation, any exemption would be available only under the general charitable purposes exemption in the same way as entities administering churches and public halls.

Where a Maori Trust Board executes a declaration of trust whereby it stands possessed of property for charitable purposes under s 24B(1) of the Maori Trust Boards Act 1955, the income of that trust can be exempt from tax under ss CW 41 or CW 42 of the ITA 2007. In order for the exemption to apply, the following conditions must be satisfied:

(a) All of the purposes specified in the declaration of trust are purposes that are specified in ss 24 or 24A of the Maori Trust Boards Act 1955;
(b) The declaration of trust has been submitted to, and approved by, the CIR;
(c) The CIR is satisfied that all requirements of charitable trust status are met with the exception of the charitable purpose and the public benefit requirements;
(d) The trust is registered as a charitable entity under the Charities Act 2005, or has started the registration process before 1 July 2008 provided that the CIR has not notified the trust that it is not a tax charity as defined in the Act.

Neither s CW 41 nor s CW 43 provides an exemption where any person is able to influence the amount of any private pecuniary benefit from the trust. The exemption under s CW 42 applies only where and to the extent to which the charitable purposes are carried out in New Zealand. These conditions are confirmed in a public ruling BR Pub 08/02, which applies for an indefinite period commencing from the first day of the 2008-2009 income year [see TIB vol 20:8 (October 2008) at 26-34].

950.60  Resident withholding tax on distributions [ss RE 16, RE 20, RE 21]

Taxable Maori authority distributions are subject to resident withholding tax (RWT). No RWT is required to be deducted where the recipient holds a valid certificate of exemption that has been sighted by the authority.
Where a taxable Maori authority distribution is made in cash or by way of credit of an amount of money to the balance of any account with the Maori authority, the amount of RWT required to be deducted is calculated as follows:

\[(\text{tax rate} \times (\text{distribution amount} + \text{credit attached})) - \text{credit attached}\]

Where:
- “Tax rate” is 17.5 per cent or, if the distribution is more than $200 and the Maori authority does not have a record of the tax file number of the recipient, 33 per cent [sch 1];
- “Distribution amount” is the amount of the distribution before the deduction of RWT;
- “Credit attached” is the amount of the Maori authority credit attached to the distribution.

Where the taxable Maori authority distribution is not a payment in cash or a credit to the balance of an account with the Maori authority, the amount of RWT is calculated as follows:

\[\frac{((\text{tax rate} \times \text{distribution amount}) - \text{credit attached})}{1 - \text{tax rate}}\]

Where:
- “Tax rate” is 17.5 per cent or, if the distribution is more than $200 and the Maori authority does not have a record of the tax file number of the recipient, 33 per cent [sch 1];
- “Distribution amount” is the amount of the distribution, disregarding any RWT deduction;
- “Credit attached” is the amount of the Maori authority credit attached to the distribution.

In this latter case, the Maori authority does not deduct the RWT but, rather, is liable to pay the amount so calculated to the CIR. This means that the recipient of the distribution receives the gross amount as income. The Maori authority is required to pay all amounts of RWT to the CIR by the 20th of the month following the month of deduction.

Where a Maori authority, in error, deducts too much RWT from a distribution, the excess may be paid to the recipient at any time on or before 31 March in the income year in which the deduction was made provided that, at the time of payment, a notice of amounts distributed has not been given to the recipient under s 31 of the TAA or a notice including the excess deduction has been returned and cancelled.

This treatment of RWT on distributions from a Maori authority is the same as applies to RWT on interest income. Members are able to claim a refund of any excess RWT by filing a return of income or by requesting an income statement/personal tax summary [see 1270.75 Income Statement/Personal Tax Summary].
Chapter 960  
Matrimonial and Relationship Property

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960.10  **Property (Relationships) Act 1976** [ss CS 4, YA 1; EGDA, s 75A]  

The application of the Property (Relationships) Act 1976 (PRA 1976) covers marriage, civil unions, and de facto relationships of both heterosexual and same-sex couples. Each of the partners to a relationship is entitled to an equal share in the family home, family chattels, and any other relationship property. If there are extraordinary circumstances that would make the equal division of property “repugnant to justice” or where a relationship is of short duration, each partner’s share is determined according to that person’s contribution to the relationship. Couples can enter into contracting-out agreements in order to preserve their autonomy in property.

The term “relationship property” is defined in s 8 of the PRA 1976. This definition also applies to the ITA 2007.

Section CS 4 provides an exemption from tax on withdrawals from superannuation funds where the withdrawal is necessary to settle the division of property following the end of a marriage or de facto relationship.

A division order made under the PRA 1976 has effect only from the time of the making of the order: *TRA Case J68* (1987) 9 NZTC 1,410.

The ITA 2007 contains provisions to eliminate any income tax liability arising where property is transferred from one person to another under a relationship agreement. A relationship breakdown need not have occurred before advantage can be taken of these provisions. The paragraphs which follow refer to the income tax circumstances applicable to various types of property.
(1) **Spouse**

The Income Tax Amendment Act 2005 updated the Revenue Acts to recognise civil unions as being equivalent to marriage and to also incorporate de facto relationships. The term “spouse” is replaced by “spouse or civil union partner”. De facto relationships are included from 1 April 2007.

For the purposes of *Staples Tax Guide* we have continued to use the word “spouse” to denote relationships by way of marriage and civil union (and from 1 April 2007, de facto relationships).

**960.15 Bloodstock** [s FB 18]

Section FB 18 applies where bloodstock, which has been used for breeding purposes, is transferred under a relationship agreement. For valuation purposes by the transferee, the bloodstock is deemed not to have been used for breeding purposes by the transferor.

**960.25 Company losses carry forward** [s FB 10]

In order for a company to carry forward a loss, it must maintain a 49 per cent continuity of minimum voting interests or market value interests where a market value circumstance exists. For the purposes of these rules, where any person has acquired shares or options in a company from a spouse [see 960.10] or former spouse under a relationship agreement, the transferee is deemed to have acquired these on the date the transferor acquired them.

**960.30 Depreciation** [s FB 21]

The transferee may claim the same depreciation allowance as would have been available to the transferor had the transferor retained the asset. The asset is transferred at its written down value for tax purposes. In the case of buildings, depreciation is allowed on the basis of the original cost price to the transferor. The transferee must use the asset in deriving gross income in order to obtain the depreciation allowance.

No depreciation is recovered where a transferor disposes of an asset under a relationship agreement. The disposal is at the lesser of the adjusted tax value at the beginning of the year of transfer and the cost price to the transferor. The transferee is deemed to have been allowed a deduction for depreciation of that asset of an amount equal to total depreciation allowed to the transferor. On subsequent disposal by the transferee, depreciation is recoverable by the transferee up to the combined total of that allowed to the transferor and transferee.

**960.35 Financial arrangements** [s FB 9]

The financial arrangement rules do not apply to various financial arrangements transferred under a relationship agreement in the circumstances mentioned in s EW 10(6).

**960.40 Herd scheme specified livestock** [s FB 15]

Any specified livestock transferred to a taxpayer under a relationship agreement is deemed to have been acquired by the transferee taxpayer during the income year in which the transfer occurred at a price equal to the national average market value of that livestock for that income year multiplied by the herd value ratio (if any), applying to the livestock in the hands of the transferor in the preceding income year. This applies when:

(a) That livestock was used by the transferor in any business carried on by the transferor, and was held by the transferor at the beginning of that income year;

(b) Its value at the end of the preceding income year was determined by the transferor under the herd scheme (or the former herd scheme); and

(c) Its value at the end of the income year in which the transfer occurred is determined by the transferee under the herd scheme.

**960.45 High-priced livestock** [s FB 17]

Where any high-priced livestock is transferred to any taxpayer under a relationship agreement:

(a) The taxpayer is deemed to have acquired the livestock:
(i) On the day on which it was acquired by the transferor; and
(ii) At a cost equal to the cost of the livestock to that transferor;

(b) The value of the high-priced livestock to be taken into account at the end of that income year is the amount of the value at which it is so transferred to the taxpayer, reduced by an amount equal to the assigned percentage of its cost price;

(c) Where the transferor had elected to adopt for the high-priced livestock a specified write down based on diminishing value, the taxpayer is deemed also to have made an election; and

(d) Where the transferor had not so elected to adopt a specified write-down based on diminishing value, the taxpayer is not entitled to make an election under these provisions unless the high-priced livestock was acquired by the transferor in the same income year as that in which it was transferred to the taxpayer.

960.50  Land transactions [ss FB 3, FB 4]
Where land to which ss CB 6, CB 7, CB 8, CB 9, CB 10, CB 11, CB 12, CB 14, CB 17, CB 20, or CB 23 would apply is transferred, the transfer is treated as a disposal and acquisition at the cost price of the land to the transferor. The transferor therefore is not liable for income tax on disposal of the land. The transferee is deemed to have acquired the land on the day on which it was acquired by the transferor.

For the purposes of s CB 13, the transferor is deemed to have disposed of the land for an amount equal to the market value of the land at the commencement of the scheme and scheme expenditure incurred prior to the transfer. The transferee is deemed to have incurred expenditure equal to the transferor’s disposal price providing the scheme was undertaken by the transferor. In the event that the transferor had not himself commenced a scheme, the transferee is deemed to have incurred expenditure equal to costs incurred by the transferor.

A transferee who acquires any land under a relationship agreement is deemed to have acquired that land on the day on which it was acquired by the transferor.

960.55  Leased assets sold [s FB 19]
Where a previously leased asset has been transferred under a relationship agreement, the transferor is not subject to the recovery provisions enabling Inland Revenue to recover lease payments previously allowed as a deduction. The asset is deemed to have been sold by the transferor at the lesser of the purchase cost to the transferor or the depreciated value for tax purposes in the transferor’s books. Where the transferee later sells the asset, the difference between the sale proceeds and the deemed transfer price is included in the transferee’s income to the extent of lease deductions previously allowed.

960.60  Non-specified livestock [s FB 16]
A transferee of relationship property who commences or recommences to derive income from non-specified livestock is deemed not to have so commenced or recommenced to derive income from non-specified livestock by virtue of that relationship property transfer. This does not exclude other circumstances from constituting the commencement or recommencement of deriving income from non-specified livestock.

If the transferee uses the livestock in deriving income from non-specified livestock, the transferee is required to continue any gradual write-down of value that the transferor was undertaking pursuant to s EC 31. This applies only where the transferee was not, in fact, deriving income from non-specified livestock before the year of transfer.

960.65  Patent rights [s FB 8]
The value of patent rights transferred is deemed to be the cost incurred by the transferor in acquiring the patents or the residue of the transferor’s costs where the transferor has already claimed a deduction on the basis of apportionment of costs over a period of years. The transferee is entitled to deduct the costs deemed to have been incurred in acquiring the rights over the remaining life of the patent.
960.70 Pensions to former employees or former partners [ss FB 11, FB 12]

An employer is allowed a deduction for pensions paid to spouses [see 960.10] of living former employees where the pension right has vested in the spouse under a relationship agreement.

Section DC 3 allows a deduction for pensions paid to former partners. The deduction is not affected by the fact that the payment may be made to some other person as a result of a relationship property agreement.

960.75 Personal property sales [s FB 2]

Property disposals within ss CB 4 and CB 5 are deemed to occur for a consideration equal to the cost to the transferor. Any excess over the transferee’s deemed purchase price, received by the transferee from a subsequent sale, is assessable to the transferee.

960.80 Resident mining operators [s FB 20]

Where a mining asset is transferred under a relationship agreement, the asset is deemed to be transferred at book value and the transferee is assessed on any profit made on a subsequent sale by the transferee in the same manner as if it had been sold by the transferor.

960.85 Share option or purchase schemes

The transferee spouse [see 960.10] is restricted from disposing of the shares until the restrictive period has terminated [see 340 EMPLOYEE SHARE PURCHASE SCHEMES].

960.90 Standing timber [ss FB 6, FB 7]

Where any timber or right to take timber or land with standing timber is transferred from any person to any other person under a relationship agreement:

(a) That transfer is deemed to be a sale or other disposition of timber, or of a right to take timber (whether or not the sale or other disposition includes other land or other assets or the land and timber are assets of a business), for a consideration equal to the cost to the transferor of the timber determined as at the date of the deemed sale or other disposition; and

(b) That amount is taken into account in calculating the income of the transferor and in calculating the cost of the timber to the transferee. This does not apply to any standing timber included with a sale or disposition consisting of ornamental or incidental trees.

960.95 Superannuation assignments

In TRA Case J96 (1987) 9 NZTC 1,541, an agreement between a husband and wife under s 21(1) of the PRA 1976 transferring a one-half share in a pension payable from a superannuation fund was held invalid for tax purposes where the rules of the fund did not provide for the assignment of pensions between husbands and wives other than pursuant to Court order under the Act.

An assignment of Government Superannuation rights made under s 21 PRA 1976 is recognised by the Government Superannuation Fund. A Court order is therefore not necessary. The Superintendent of the Government Superannuation Fund has the authority to approve assignments of Government Superannuation rights, upon application in writing.

If an assignment of pension rights satisfies the provisions of the Government Superannuation Fund Act 1956, it will also meet the requirements of the ITA 2007 [see PIB 164 (August 1987)].

960.100 Trading stock [s FB 13]

Where trading stock is transferred under a relationship agreement, the value at which it is transferred depends on whether or not the transferor was holding and using that stock in a business. Where the transferor was using the trading stock in a business:

(a) Trading stock held at the beginning of the year of transfer is treated as a sale and acquisition for the greater of its value under s EB 3 for the transferee at the end of the year of transfer or its value under s EB 3 for the transferor at the end of the preceding year; or
(b) Trading stock acquired by the transferor during the year of transfer is treated as a sale and acquisition at the transferor’s cost price.

For the purposes of this rule, trading stock does not include specified livestock unless it is used in a dealing operation and ss FB 14 and FB 17 apply. Where the transferor has not used trading stock in business, it is treated as a sale and acquisition at the transferor’s cost price. Where trading stock, used in the transferor’s business, is disposed of to the transferee under a relationship agreement, all sale proceeds received by the transferee must be taken into account in determining the transferee’s income regardless of whether the transferee uses that trading stock in a business.

**960.105 Tax awarded by the Court**

In *Von Ah v Von Ah* (1994) 16 NZTC 11,085 (HC) after the division of a farm and other relationship property in Family Court proceedings, the High Court ordered that a credit be given by the wife to reflect the fact that a tax contingency on livestock would apply to the husband at a future time.
Chapter 980

Mining Companies and Operators

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980.05 Petroleum mining

The expenditure rules affecting the petroleum mining sector supplement the general permission and override the capital limitation. Thus, they are effectively a code. Much expenditure that would otherwise be of a capital nature is deductible, and capital assets treated as on revenue account.

The legislation dealing with petroleum mining expenditure splits the expenditure between exploration activities and development activities.

(1) Petroleum mining income [ss CT 1, CT 2, CT 3, CT 4, CT 5, CT 6, CT 6B, CT 7]

The provisions for income are contained principally in ss CT 1 to CT 7, which also contains a number of the definitions relating to petroleum mining. Sections CX 42 and CX 43 apply to the consideration received from the disposal of interests in controlled petroleum mining entities and the assessability of farm-in expenditure to the farm-out party. Section CZ 8 deals with excess expenditure under farm-out arrangements before 16 December 1991.

(2) Petroleum mining expenditure [ss DT 1 to DT 20]

The expenditure provisions are contained principally in ss DT 1 to DT 20. Sections DZ 3 to DZ 7 apply to petroleum mining development expenditure and farm-out arrangements before 16 December 1991. Sections EJ 12 to EJ 20 apply to deductions that are spread, s EZ 3 applies to petroleum mining expenditure incurred between 1 October 1990 and 15 December 1991. Section GB 20 applies to extend arrangements that have a tax avoidance effect to arrangements involving disposal of petroleum mining assets, petroleum mining expenditure arrangements involving farm-outs and arrangements between associated persons.
980.10 Definition of petroleum miner [ss CT 6, CT 6B]

A petroleum miner is a person who undertakes petroleum mining operations in a permit area for which the person has a petroleum permit. Petroleum mining operations are activities carried out in connection with the following:

(a) Prospecting or exploring for petroleum;
(b) Developing a permit area for producing petroleum;
(c) Producing petroleum;
(d) Processing, storing, or transmitting petroleum before its dispatch to a buyer, consumer, processor, refinery, or user; or
(e) Removal or restoration activities.

These activities do not include further treatment when:

(a) It occurs after the well stream has been separated and stabilised into crude oil, condensate, or natural gas; and
(b) It is done
   (i) By liquefaction or compression; or
   (ii) For the extraction of constituent products; or
   (iii) For the production of derivative products; and
(c) It is not treatment at the production facilities.

The consideration for the petroleum mining operations must be in the form or, or contingent on, the production or petroleum for the permit area, or profits from the production of petroleum from the permit area, or an interest or a right to an interest in the petroleum permit. A petroleum permit is any one or more of a prospecting permit, an exploration permit and a mining permit [s YA 1].

980.15 Petroleum mining income [ss CT 1, CT 2, CT 3, CT 4, CT 5, CT 6, CT 7, CX 42, CX 43]

As well as the assessable income derived from the petroleum mining operations, the following amounts are specifically taxable:

(a) The consideration derived from the disposal of exploratory material (anything acquired with exploratory well expenditure or prospecting expenditure [ss YA 1, CT 1(1)]);
(b) The consideration derived from the disposal of a petroleum mining asset (ie a petroleum permit or permit-specific asset) [ss CT 7, CT 1(2)]; and
(c) The consideration derived for damage to an petroleum mining asset, that is not a petroleum permit [s CT 2].

Income arising from exploratory well expenditure [s CT 3] is income of the petroleum miner. This income is essentially a clawback of exploratory well expenditure and arises when a petroleum miner commences using the well for the commercial production of petroleum. While the expenditure is added back as income, the expenditure is then able to be deducted under s DT 5 and the spreading rules in s EJ 12, as development expenditure.

With effect from 3 December 2002, the consideration a person derives from disposing of shares or trust interests in a controlled petroleum mining entity is excluded income under s CX 43, and the cost of those shares or trust interest is not deductible in terms of s DT 13. Essentially then the disposal is treated as being on capital account, as is the acquisition by the purchaser.

Prior to this date, such disposals and purchases were treated as being on revenue account. The change in tax treatment does not apply in respect of a contract entered into prior to 3 December 2001 when the sale was to a non-associated person and the shares or other interest are transferred to the purchaser within a year on the date on which the contract was entered into.
Mining Companies and Operators

**TaxNote:** Controlled petroleum mining entities are required to furnish under s 65 of the TAA, in their annual return, details of any disposal which ss CX 42 and DT 13 apply. Specifically, the date of disposal, the number of shares or proportion of the trust represented by the trust interest, and the name of the persons acquiring and disposing of the shares or trust interest. A controlled petroleum mining entity is defined in s YA 1. In general terms it is an entity when 90 per cent or more of the value of its shares are held by five or fewer people, and the market value of the petroleum permit represents 75 per cent or more of the entities net assets.

**980.20 Non-resident companies involved in exploration and development**

Income derived by a non-resident company from exploration and development activities is exempt from income tax where it is derived in the period that:

(a) Starts with the beginning of the 2005-2006 income year of the non-resident company; and

(b) Ends on 31 December 2009.

The Minister of Revenue has announced that this exemption is to be extended to 31 December 2014.

Exploration and development activities covered by the exemption are those undertaken for the purpose of identifying and developing exploitable petroleum deposits in an offshore permit area. The exemption is limited to activities in the nature of drilling a well or operating a ship to provide seismic survey readings. The exemption does not extend to the operation of support vessels.

Section CW 57 overcomes the problems caused by New Zealand’s tax system for non-residents engaged in these activities, that find themselves with a taxable presence in New Zealand when their activities give rise to a permanent establishment.

**980.25 Petroleum mining expenditure**

The approach taken under the rules for petroleum miners is to divide petroleum mining expenditure into two distinct categories: development expenditure and exploration expenditure.

Exploration expenditure is generally deductible in the income year incurred, whereas development expenditure is spread over seven income years.

1) Exploration expenditure

Petroleum exploration expenditure is defined in s YA 1 as:

(a) Exploratory well expenditure [defined in s YA 1]; and

(b) Prospecting expenditure [defined in s YA 1]; and

(c) Expenditure to acquire an existing privilege, a prospecting permit for petroleum, or an exploration permit for petroleum.

Exploration expenditure excludes “residual expenditure”, any expenditure that is deductible under subpart DT or DZ (both of which relate to petroleum mining expenditure), and expenditure that is treated under s DT 6 as development expenditure (ie expenditure on acquiring, constructing or planning petroleum mining assets and which is directly related to a permit area). Residual expenditure is defined in s YA 1 and means application fees payable for a petroleum permit, insurance premiums, royalties paid under the Petroleum Act 1937 or the Crown Minerals Act 1991, rates, land and building lease payments, interest and financial arrangements to which the old financial arrangement rules apply. It also includes expenditure deductible under s DB 33 (scientific research).

Exploration expenditure also includes consideration paid to another petroleum miner for a prospecting permit, prospecting permit for petroleum, or a petroleum exploration permit [s DT 8].

The deductibility of exploration expenditure is governed by ss DT 1 and DT 2.

Section DT 1 states that petroleum exploration expenditure is deductible. However, this is modified by s DT 2, that adjusts the deductible expenditure for any consideration received in respect of the property.
Section DT 2 applies when, under an arrangement, a person incurs expenditure that is deductible under s DT 1, and the person, or an associated person, disposes of any property under an arrangement, or disposes of any property under any rights given under the arrangement (put and call option for example). Section DT 2 does not include property that is exploratory material, a prospecting permit for petroleum, or an exploration permit for petroleum.

If the conditions in s DT 2 are satisfied, the deductible expenditure arising under the arrangement, that is expenditure deductible under s DT 1, is the greater of zero and the amount calculated under the formula:

\[
\text{expenditure} - (\text{consideration} - \text{lesser amount})
\]

Where:
- “Expenditure” is the amount of expenditure for which the person would (before s DT 2 applied) be allowed a deduction in the income year under s DT 1.
- “Consideration” is the total consideration for the property that is derived before or during the income year.
- “Lesser amount” is the lesser of:
  (a) The amount of the consideration; and
  (b) The amount of the expenditure that would (ie but for the rule in s DT 2) be allowed as a deduction in previous income years under s DT 1(1).

If the conditions in s DT 2 are satisfied, the deductible expenditure arising under the arrangement, that is expenditure deductible under s DT 1, is the greater of zero and the amount calculated under the formula:

\[
\text{previous expenditure} - \text{consideration}
\]

Where:
- “Previous expenditure” is defined as the amount of expenditure for which a person would (ie but for s DT 2) be allowed a deduction in previous years under s DT 1(1).

**Example:**

A petroleum miner incurs $100 of exploration expenditure in 20X1 and $120 in 20X2. In 20X2, the person derives $300 from a disposal of property under an arrangement to which s DT 2 applies. The deduction is calculated as follows:

\[
\text{expenditure} - (\text{consideration} - \text{lesser amount})
\]

20X1: 100 - (0 - 0) = 100
20X2: 120 - (300 - 100) = - 80

The deduction for 20X1 is (subject to the further adjustment in s DT 2(3) below) $100. Under s DT 2(2) the deduction for 20X2 is the greater of zero and the amount calculated under the above formula. Thus, the deductions for 20X2 are reduced to zero. The further calculation required in respect of the previous year is:

\[
\text{previous expenditure} - \text{consideration}
\]

20X1: 120 - 300 = - 180

Under s DT 2(3) the deduction is the greater of zero and the amount calculated under the above formula. Thus, the deductions for 20X1 are reduced to zero. When looked at as a whole, the petroleum miner has outlaid $220 exploration expenditure, but received $300 from the disposal of property. The miners deductions have been reduced to zero.

The CIR is given authority to amend any assessment despite the statutory time bar.

(2) **Development expenditure**

Petroleum development expenditure is defined in s YA 1 as:

(a) Directly concerns a permit area; and
(b) Is for acquiring, constructing, or planning petroleum mining assets.

Development expenditure excludes “residual expenditure,” petroleum exploration expenditure or any other expenditure that is deducted under the general permission rules (ie not deductible under subpart DT). Other expenditure could include depreciation on mining-specific assets and general administration overheads, for example. Residual expenditure means application fees payable for a petroleum permit, insurance premiums,

Consideration paid to acquire a petroleum mining asset (other than a prospecting licence, prospecting permit for petroleum, or a petroleum exploration permit) from another petroleum miner is development expenditure [s DT 8].

Development expenditure is allowed as a deduction under s DT 5, but is spread over the year of first commercial production and the six income years following under s EJ 12 in the case of on-shore development. For off-shore development, the seven-year period starts with the income year in which the expenditure incurred.

New rules in ss EJ 12 and EJ 12B apply to development expenditure incurred in a permit area where that expenditure is incurred on or after 1 April 2008. In addition to the seven-year spread, taxpayers have the option of electing to spread the expenditure under the reserve depletion method. The election is available only in the year in which the commercial quantities of petroleum are produced in that permit area. The election then applies to that particular permit area and is irrevocable.

Under the reserve depletion method, the allowable deduction for the permit area is calculated as follows:

\[(\text{reserve expenditure} - \text{previous expenditure}) \times (\text{reserve depletion for the year} / \text{probable reserves})\]

Where:

**Reserve expenditure** is the total petroleum development expenditure that relates to the petroleum mining development for the current income year or an earlier income year to which the reserve depletion method applied.

**Previous expenditure** is the total petroleum development expenditure that relates to the petroleum mining development and that has been allocated to an earlier income year to which the reserve depletion method applied.

**Reserve depletion** for the year is the amount, expressed in barrels of oil equivalent, of petroleum produced from the petroleum mining development for the income year.

**Probable reserves** is the amount, expressed in barrels of oil equivalent, of the reserves of petroleum for the petroleum mining development that are not yet proven but are estimated, at the beginning of the income year, to have a better than 50 per cent chance of being technically and commercially producible.

A “petroleum mining development” is defined as being a place where one or more of the following activities is carried out:

(a) Developing a permit area for producing petroleum;
(b) Producing petroleum;
(c) Processing, storing, or transmitting petroleum before its dispatch to a buyer, consumer, processor, refinery, or user; or
(d) Removal or restoration operations.

It does not include activities that include further treatment to which all of the following apply:

(a) It occurs after the well stream has been separated and stabilised into crude oil, condensate, or natural gas; and
(b) It is done:
   (i) By liquefaction or compression; or
   (ii) For the extraction of constituent products; or
   (iii) For the production of derivative products; and
(c) It is not treatment at the production facilities.

**Example:**
(taken from TIB vol 21:8 (October/November 2009, at 104)

The first $35 million of development expenditure (incurred in December 2007) is amortised over seven years on a straight-line basis. A deduction of $5 million is allocated to each year until the expenditure is completely amortised at the end of 2014. The remaining $70 million is allocated on a straight-line basis until commercial production begins in January 2009. Slick Oil then elects to allocate the remaining development expenditure under the reserve depletion method. As at January 2009, the balance of unamortised development expenditure incurred on or after 1 April 2008 is $67.5 million.

Applying s EJ 12B, the balance of reserve expenditure is $67.5 million. With probable reserves estimated at 100 million barrels and first-year production totalling 40 million barrels, a $27 million deduction for development expenditure is allocated to the 2009 income year.

At the end of 2009, the amount of probable reserves is revised down by 20 million barrels to 40 million barrels. The balance of reserve expenditure less previous expenditure is $40.5 million. Total production during 2010 is 20 million barrels. The deduction for development expenditure for 2010 is therefore $20.250 million.

Expenditure incurred on petroleum mining assets is treated as development expenditure when, at the time the asset is acquired, petroleum is produced in commercial quantities on a continuing basis under the permit or an application for a mining permit for the permit area has been made by a person entitled to a mining permit under s 32(3) of the Crown Minerals Act 1991.

However, on relinquishment of a petroleum permit all of the non-deducted expenditure balance applicable to that permit, or permit-specific assets may be deducted in the year of relinquishment [s EJ 13]. When a petroleum mining asset is disposed of, the remaining balance is allowed as a deduction in the income year that the income from the asset is assessable under s CT 1. Rules apply to limit the deductions available when petroleum mining assets are sold to associated persons.

Under s EJ 13B, a deduction is allowed for the cost of a dry production well. For the deduction to be available, the expenditure must be incurred on or after 1 April 2008, and the well must be one that will never produce commercial quantities of petroleum (as opposed to having ceased producing commercial quantities). The deduction for the balance of the cost of the well is available in the year in which drilling ceases and the well is abandoned.

Section EJ 13C provides a deduction for expenditure on or after 1 April 2008 on a well that has ceased producing commercial quantities of petroleum. For the deduction to be available, the well must be abandoned and the reserve depletion method must have been used for that permit area. The deduction is allowed in the year in which the well is abandoned.

If a petroleum miner has incurred exploratory well expenditure and then uses the well for the commercial production of petroleum, and the exploratory well expenditure in then treated under s CT 3 as income of the miner, the amount equal to the amount treated as income is treated as petroleum development expenditure in the income year in which commercial production starts, and is spread accordingly [s DT 7].

(3) Expenditure deductible in the year incurred

Expenditure on removal or restoration operations may be deducted from gross income in each year the expenditure is incurred [s DT 16], and if that income is insufficient may be carried back to previous years’ income, successively [s EJ 14].

Deductions are allowed for the cost of repairing damaged mining assets of the kind described in s CT 7(1)(b) and (c) (ie mining assets excluding a mining permit) [s DT 12]. See also the exclusions from the definitions of “petroleum development” and “exploration expenditure” as discussed above.

(4) Farm-out arrangements

A “farm-out arrangement” is defined is s YA 1, and is essentially an arrangement where a farming party (farm-in party) agrees with a petroleum miner (farm-out party) to incur expenditure for work in a permit area either by undertaking or paying for that work. In return for incurring this expenditure, the farm-in party acquires a right or option to any future revenue from petroleum that arises from that permit or subsequent permit.
The expenditure incurred as part of a farm-out is excluded income in the hands of the farm-out party [s CX 43]. Expenditure incurred on the part of the farm-in party is either exploration or development expenditure, depending on whether an exploration permit or a development permit is involved [s DT 14].

(5) Petroleum mining operations undertaken outside New Zealand

Expenditure incurred in undertaking petroleum mining operations outside New Zealand is ring-fenced under s DT 1A. The provision applies to expenditure incurred on or after 4 March 2008. The ring-fencing provision relates to exploration expenditure, development expenditure and residual expenditure. Under the provision, the amount of any deduction is limited to the amount of income derived from petroleum mining operations undertaken outside New Zealand. The provision is not jurisdiction-specific. Therefore, expenditure incurred in relation to operations carried on in one country can be offset against income derived from operations in another country. However, none is able to be offset against income derived from petroleum mining operations undertaken in New Zealand. Any expenditure for which there is insufficient income to enable a deduction is carried forward to the next income year. The carry-forward is subject to the same continuity of shareholding requirements as other tax losses [See 940 LOSSES].

980.30 Companies engaged in exploring or searching for minerals

The principal provisions for companies engaged in mineral mining are contained in ss CU 1 to CU 29, CX 45, CX 46, CZ 2, DU 1 to DU 12, in relation to income and ss DU 1 to DU 12 in relation to deductions.

(1) Companies to which the mining company rules apply [s CU 22]

The mining company rules apply to a New Zealand company if:

(a) Its only or main source of income is the business of mining any specified mineral in New Zealand; or

(b) It carries on, or proposes to carry on, in New Zealand as its only or main undertaking the activities of:

(i) Exploring, searching, or mining any specified mineral in New Zealand; or

(ii) Performing development work relating to exploring searching or mining any specified mineral.

An activity which is defined in (b) immediately above does not include an activity done or to be done as a service to another person for reward, unless the reward:

(a) Is wholly or mainly related to and dependent on the production of the specified mineral; or

(b) Arises wholly or mainly through participation in profits from the production of the specified mineral.

(2) Specific definitions [ss CU 21 to CU 29]

The meaning of a “specified mineral” is set out in s CU 28 and means any of the following minerals:

(a) Alumina minerals (such as bauxite, gibbsite, diasporic, and corundum), aluminium refractory clays and fireclays containing in either case over 30 per cent alumina in the fired state, andalusite, antimony, asbestos, barite, bentonite (other than bentonite mined in what was formerly the county of Malvern), bituminous shale, chromite, copper, diatomite, dolomite, feldspar, fluorite, gold, halloysite, kaolin, kyanite, lead, magnesite, manganese, mercury, mica, molybdenite, nickel, perlite, phosphate, platinum group, pyrite, silica in lump form used only in the production of silicon carbide, silicon metal, or ferro sillimanite, silver, sodium chloride, sulphur, talc, tin, titanium, titanomagnetite, tungsten, uranium, wollastonite, zircon; or

(b) Includes a mineral declared to be a specified mineral in a Gazette notice by the Minister.

Every mining company is assessable for income tax as if it were any other kind of company, with its income comprising income from mining and from non-mining. Any net loss incurred in either class of income is to be deducted from any income derived from the other source. An apportionment of the total income between processing operations and mining operations is made. Exploration and development expenditure are
deductible in calculating the net income derived from mining. Where exploration and development expenditure has been allowed to a mining company under these provisions a deduction cannot be allowed for the same expenditure under any other provision of the ITA 2007. Nor are any of the investment allowances available. The mining income includes the value of any assets previously taken into account in calculating exploration or development expenditure which are transferred for use in the non-mining activities of the company. The sale of any mining asset, right, or information is taken into account in determining the income of a mining company.

The definitions of income from mining, mining development expenditure and mining exploration expenditure are contained in ss CU 21, CU 23 and CU 24 respectively.

The definitions of mining operations, mining venture, resident mining operator are contained in ss CU 25, CU 26 and CU 27 respectively. The following definitions are contained in s CU 29:

(a) Associated mining operations;
(b) Holding company;
(c) Initial treatment;
(d) Loan;
(e) Mining holding company;
(f) Mining or prospecting right;
(g) Mining prospecting information;
(h) Mining purposes;
(i) Mining share;
(j) Non-resident mining operator;
(k) Prescribed period;
(l) Prescribed portion; and
(m) Reinvestment profit.

980.35 Income from mining [ss CU 1, DU 7]

The income derived by a mining company is divided into income from two sources, namely income from mining or income other than income from mining. This is because historically income from mining was taxed at 33 per cent, when the general company tax rate applicable to other income was 45 per cent.

Any net loss incurred in either class of income is able to be deducted from any income derived from the other source. However, there is a limit on the amount of the mining outgoing excess that can be deducted against the income other than income from mining. Essentially, the excess mining outgoings are required to be reduced by one-third when offset against non-mining income. Again because of the different tax rates that were applicable to mining and non-mining income.

This rule which continues to operate, is contained in s DU 7, and provides that the limit of the deduction in these circumstances is the lesser of:

(a) Two-thirds of the “mining outgoing excess;” and
(b) The greater of zero and the amount in the formula:

\[
\text{non-mining income} - \text{non-mining expenditure}
\]

The “mining outgoing excess” is defined in s DU 7(4) as the amount that is the greater of zero and the amount given by the formula

\[
\text{mining expenditure} - \text{income from mining}
\]

Where “mining expenditure” is all expenditure or loss of the mining company for that income year, including an amount of income appropriated to mining exploration or development under s CU 4.
If a mining company carries on processing operations (i.e., in addition to its activities as a miner it produces products by processing the specified minerals), and disposes of the products, the CIR must classify the mining company’s income from the disposal as income from mining or income other than from mining [s CU 2(2)]. Sections CU 2(3) and CU 2(4) provide matters that must be taken into account in making the apportionment.

980.40 Mining development and exploration expenditure [ss DU 1, DU 2]

In calculating the assessable income from mining, exploration and development expenditure are deductible under s DU 1. The amount of the deduction is determined under s DU 2, which section describes the consideration that the mining company is treated as giving for the asset and the consideration that the person who disposes of the asset to the mining company is treated as receiving for it. The exploration and development expenditure deductions are taken into account in determining the mining outgoing excess for the purpose of the limit on the offset against non-mining income [see 980.35].

980.45 Compensation and expenditure in respect of lost, destroyed, or damaged assets [ss CU 4, CU 5, CU 6, CU 7, CU 8, DU 3, DU 8(3)]

The mining rules contain comprehensive provisions dealing with the situation when an asset is lost, damaged or destroyed, and insurance or other indemnity receipt is received in respect of that event. The essence of the rules is to treat any expenditure in repairing or replacing the asset as deductible mining expenditure, and any amount of insurance or other indemnity as income.

The rules below apply when:

(a) A mining company has acquired an asset as part of the development or exploration expenditure;
(b) Has been allowed a deduction s DU 1 or s DZ 12(1)(a) (mineral mining: 1954 to 2005);
(c) The asset is lost, destroyed or damaged; and
(d) The company receives insurance or other indemnity or compensation in respect of for the loss, destruction or damage.

Section CU 5 treats the insurance, indemnity or compensation as income. Section CU 5 applies when the asset for which the insurance or other payment received in respect of the loss has not been used to replace or repair the asset. The proceeds of scrapping the asset are also income under s CU 5.

Section CU 6 provides that ss CU 7 and CU 8 apply if the miner gives notice to the CIR within the time for furnishing a return of income that the insurance or other indemnity or compensation received will be used to repair or replace the asset. The repair or replacement is must be started by the end of the second income year after the income year in which the loss, destruction or damage occurred.

Section CU 7 treats the amount of insurance, indemnity or compensation as not being income from mining. Neither are the proceeds received from scrap (if any). If the amount of expenditure incurred in repairing or replacing the asset exceeds the insurance or other indemnity receipts, the amount of the excess is allowed as a deduction under s DU 3(2), and taken into account in determining the mining outgoing excess for the purpose of the limit on the offset against non-mining income under s DU 7.

Section CU 8 provides that if the amount of expenditure incurred in repairing or replacing the asset does not exceed the insurance or other indemnity receipts, the amount of the excess is income from mining.

The following provisions are also relevant:

(a) Section DU 3(5) to (8) applies to allow a deduction for expenditure that the miner has incurred on repairing or replacing an asset after the time the CIR considered to be reasonable within which to replace or repair the asset; and
(b) Sections CU 10(3) and DU 8(3) provides that the asset repaired or replaced is the same asset as the one lost, damaged or destroyed.
980.50  **Mining assets used to derive income other than income from mining** [s CU 10]

Mining income is derived when mining assets previously taken into account in calculating exploration or development expenditure are transferred for use in the non-mining activities of the company.

The mining income is an amount equal to the market value of the asset on the first day of each period in which it is used, wholly or mainly, to derive income other than income from mining.

980.55  **Disposal of mining assets** [s CU 3]

The general rule for mining company assets (including mining prospecting information or prospecting rights) is that when the asset has been disposed of in circumstances when it was acquired as exploration or development expenditure, the income of the mining company includes the consideration received in respect of the asset’s disposal.

Sections CU 3(3)-(7) determine consideration that the mining company is treated as receiving for the asset when the consideration is other than cash, or the asset is disposed of to an associated person (when consideration is deemed to equal market value), or the parties give the CIR a notice of their agreement as to value.

An exclusion to the rule on disposal is made for assets forfeited [s CU 3(2)].

**TaxNote:** The CIR has issued a policy statement in TIB vol 7:7 (January 1996) at 25-26, about disposals when no deduction for acquisition was claimed. The CIR stated that some taxpayers consider that there is a discretion whether to follow the rule in s CU 3 on the basis that if a deduction is not claimed on the acquisition of a mining asset, any proceeds on its sale are not assessable. The CIR does not agree with this reasoning. In the CIR’s view s CU 3 applies whether or not the taxpayer has claimed a deduction.

980.60  **Income appropriated to expenditure** [ss CU 9, DU 4]

A mining company is allowed a deduction for an amount of income appropriated toward mining exploration or development expenditure. The deduction is allowed to the extent that all of the following apply:

(a) The appropriation is made within two months of balance date (or longer with the CIR’s agreement);
(b) The appropriation is not more than its net income;
(c) It is not actually spent in that income year; and
(d) It will be used as mining exploration expenditure or development expenditure before the end of the second income year following the income year to which the appropriation relates.

The deduction is taken into account as mining expenditure, and thus is included in any calculation of the mining outgoing excess in s DU 7(4).

The amount that is allowed as a deduction under s DU 4 is income of the mining company in the following income year under s CU 9.

980.65  **Losses of mining companies and petroleum miners** [ss IS 1, IS 2, IS 5]

Where the CIR is satisfied that a tax loss of a mining company, a resident mining operator, or a non-resident mining operator for any tax year arises as a result of exploration expenditure or development expenditure relating to a permit area, the following provisions apply:

(a) The tax loss which arises for each permit area must be determined; and
(b) In the case of a mining company, any loss from a permit area may be offset against the net income to the extent that it does not exceed the company’s net income if its sole source of income for the year of claim was from that permit area. It may be offset against the net income for following years to the extent that it does not exceed the net income of the company if its sole source of income for that year was from that permit area [s IS 2].

Special provisions exist for any net loss of a petroleum mining company carried forward from the 1990-1991 or any earlier income year [s IZ 3].
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980.70  Loss carry back by petroleum miners [s EJ 14]
If a petroleum miner would have a net loss in a year in which expenditure for removal or restoration operations is incurred, or a permit is relinquished, and deferred deductions are allowed under s EJ 14, the allowable deductions for that year are reduced by the amount that would otherwise be a loss. The amount is instead allowed as a deduction in the years preceding the loss year, beginning with the income year immediately preceding the loss year. The petroleum miner has the right to amend its returns for those income years in spite of the statutory time bar.

980.75  Losses carried forward [ss IS 2, IS 3, IS 6]
Mining company losses can be carried forward even where the 49 per cent continuity of ownership rule under s IA 5 has been breached. However, such losses can be offset only against assessable income from that mining permit area derived in later income years [s IS 2].

Where a mining company has a loss carried forward and it has ceased to be a mining company before the end of a year, it is treated as having continued to be a mining company for the whole of that tax year [s IS 6].

Generally, a mining company is not included in a group of companies for purposes of offsetting losses within the group. However, a mining company and a holding company (that is not a mining company), which would be included in a wholly-owned group in an income year may, in special circumstances, may offset net income of the mining company against a net loss of the holding company [s IS 3].

980.80  Profits on sale of mining shares [ss CU 14, CU 15, CU 16, CU 20, CU 29, CX 44, CX 45, CX 46, DU 11]
Special provisions apply to the taxation of a profit made by a company from the sale of shares in a mining company or a mining holding company, which would ordinarily be taxable because the business of the company is share dealing, or because the shares were acquired in an undertaking or scheme for resale. The provisions aim at deferring the taxation of the profit if the profit (described as reinvestment profit) is reinvested for mining purposes.

The cost figure for the purpose of calculating the profit on the sale of a mining share is an amount equal to the difference between “a” and “b” where:

a  is the sum of the purchase price of the share and any call paid on that share; and

b  is the sum of the reinvestment profit included in the purchase price and the amount of any reinvestment profit included in the call [s DU 11].

The circumstances under which a profit made by a company on the sale of a mining share is excluded income under subpart CX are:

(a)  Where the shares are sold to a mining company or a mining holding company and the consideration consists of shares in the mining company or the mining holding company issued to the vendor company; or

(b)  Where the consideration is used, or is to be used, for mining purposes within a period of six years following the year in which the sale took place.

“Mining purposes” means:

(a)  Subscribing for, or paying calls on, shares in any mining holding company or any mining company; or

(b)  Making loans to a mining company to finance its mining operations or associated mining operations, or to finance exploration or development expenditure of the mining company; or

(c)  Making loans to a mining holding company, where the loans made are to be used to finance mining operations or associated mining operations to be carried out by a mining company or finance exploration or development expenditure of a mining company.
If any part of that consideration is used for non-mining purposes in the period of six years referred to above, or remains unused for mining purposes at the end of that time, that part is income in the year it is used for non-mining purposes, or at the end of that period, as the case may be [s CU 15].

When the reinvestment profit which had been used for a loan to a mining company is repaid in whole or in part, the portion repaid is income unless the repayment is further invested for mining purposes within six income years following the year of repayment.

Where the CIR is satisfied that in calculating the profit a deduction was made for mining reinvestment purposes and/or reinvestment profit included in share purchase price, on sale the amount to be included as income is calculated as:

\[(\text{reinvestment profit amount} / \text{loan amount}) \times \text{repayment}\]

However, the resultant profit is not assessed to the extent that the shares are sold to a mining company in return for shares in that company, or that the proceeds of sale are to be used for mining purposes within a period of six years following the income year of sale.

On the liquidation of a mining holding company or of a mining company, any share held is deemed to be sold to the company and all distributions on the liquidation are deemed to be consideration for the sale, and any resultant profit is income unless the consideration received on distribution is in the form of shares allotted to the vendor in another mining holding company or mining company or is used for mining purposes within the prescribed period [ss CU 14, CX 45].

### 980.85 Assessment of companies holding shares in mining companies

[ss CU 17, CU 18, CU 19, CU 29, DU 12]

A New Zealand company which holds shares in a mining company and which has made loans to the mining company may deduct from its income any amounts written off the loans, but not interest. The deduction must not exceed the smaller of either one-half of the holding company’s taxable income for the year of the writing off, or the holding company’s proportionate share (with other holding companies’ shares) of the mining company’s total outgoings on exploration and development, reduced by any deductions claimed in any earlier years. In the event of the mining company being successful and repaying the holding company, the CIR has the power, at any time, to reopen the assessments on the holding company and disallow the deductions previously allowed. There are also safeguard provisions for the CIR to reassess the holding company if the income of the mining company should warrant this, or where the holding company which had received a deduction sells its shares at a price in excess of the amount paid on the shares.

### 980.90 Resident mining operators

[ss CU 12, CU 27, DU 9]

The term “resident mining operator” means a person (not being a mining company or a petroleum mining company) who is resident in New Zealand and who carries on, or proposes to carry on:

- Personally and actively in the field;
- As a business; and
- Under an exploration, prospecting or mining permit,

the activities of exploring or searching for or mining any specified mineral or performing development work relating to such exploring or searching or mining. Activities carried on as a service to any other person for reward do not qualify unless the reward is related to production of the specified mineral, etc or by way of participation in profits from the production of the specified mineral, etc. The activities must be carried on “as a business” and the person must be personally and actively engaged in the mining venture. These words are included to counter any claims for deduction under the section by a hobbyist or casual prospector.

The provisions follow the same general lines as those relating to mining companies but there are several points of difference:

- Exploration and development expenditure incurred is deductible on the same basis as for mining companies but no provision can be made for expected expenditure in advance;
(b) Losses from one type of income can be set-off against the other on a dollar for dollar basis but are subject to the proviso that the set-off of a mining loss against non-mining income cannot exceed one-half of the non-mining income; and

(c) Where a mining asset is transferred under a relationship property agreement, the asset is deemed to be transferred at book value and the transferee is assessed on any profit made on subsequent sale in the same manner as if it had been sold by the transferor.

980.100 Non-resident mining operators [ss CU 13, CU 29, DU 10]

“Non-resident mining operator” means a person who is not resident in New Zealand who carries on, personally and actively in the field, a mining venture.

“Mining venture” means a venture where all of the following apply:

(a) It is carried on, or is proposed to be carried on, in New Zealand, as a business;

(b) It is carried on, or proposed to be carried on, under an exploration, prospecting, or mining licence; and

(c) It consists, or is proposed to consist, of the activities of exploring or searching for or mining any specified mineral or performing development work for reward based on production or participation in profits.

The term “person” includes a company.

The provisions follow the same general lines as those relating to mining companies, but with these differences:

(a) The income is taxed at the company tax rate irrespective of whether the operator is an individual or a company or any other form of association.

(b) Any income derived by a non-resident mining operator from outside the mining venture is separately assessed. Unlike the provision regarding resident mining operators, a non-resident mining operator can deduct a provision for two years estimated exploration and development expenditure in advance.

A non-resident mining operator who derives any income otherwise than from a mining venture shall be separately assessed and liable for income tax for that income without regard to any income derived in that income year from any such mining venture or to any expenditure or loss incurred in such mining venture.
Chapter 990

Motor Vehicles

990.10 Tax issues

Tax issues relating to motor vehicles include:

(a) Deductibility of motor vehicle expenses [see 990.15, 990.25];
(b) Logbook and record-keeping requirements [see 990.30, 990.55];
(c) Depreciation [see 990.70, 990.75];
(d) Fringe benefit tax [see 990.90]; and
(e) Tax planning considerations [see 990.95].

The deductibility of motor vehicle expenses is given special treatment in the income tax legislation [subpart DE], recognising the widespread use of the motor vehicle as a business asset and the nature of the asset as one that is often used for both business and private purposes. Subpart DE sets out the rules for determining the proportion of the business use of a motor vehicle when it is used partly for business and partly for private purposes; it is essentially a code for the deductibility of motor vehicle expenditure and depreciation.

990.15 Deductibility of motor vehicle expenses [ss DA 1, DB 56, DE 1]

Under the general permission [s DA 1], a deduction for motor vehicle expenses and depreciation is allowed to the extent that the expenditure is incurred by the taxpayer in deriving the taxpayer’s assessable or excluded income or necessarily incurred by the taxpayer in the course of carrying on a business for the purpose of deriving assessable or excluded income [see 240.10].

If a motor vehicle is not used wholly for business purposes, a deduction is allowed only for expenditure and depreciation relating to the business use of the vehicle. The rules for determining the business use are set out in ss DE 2 to DE 12 [see 990.25 to 990.65]. The apportionment rules do not apply to:
Motor Vehicles

990.20

(a) Companies;
(b) Persons whose only income is from employment;
(c) A motor vehicle that is used only for deriving income or to provide a fringe benefit [s DE 1(2)].

Subpart DE is therefore targeted at self-employed persons (including partners) whose motor vehicles have some private or non-business use.

The types of expenses that are likely to be deductible include fuel, oil, repairs and maintenance (tyres, servicing, parts, panel beating, cleaning, and so on), insurance, warrant of fitness fees, registration fees, road user charges, and parking.

Inland Revenue has confirmed that the cost of leasing a parking space for a business vehicle is deductible [see TIB vol 5:2 (August 1993) at 9]. According to Inland Revenue, if a car is used extensively for business purposes a deduction will be allowed for the cost of using a parking space. However, where a taxpayer is merely using a car as a matter of convenience for travel between home and place of business, the expenditure is of a private nature and not deductible.

An employer or associated person who is treated under s CX 7 as having a right to use a motor vehicle during a period that the employee uses, or has a right to use, the vehicle privately [see 540.60] is allowed a deduction for the expenditure incurred in operating the motor vehicle during that period. The deduction is allowed because the vehicle is subject to FBT during the period of private use. This provision overrides the private limitation and the exempt income limitation, but the general permission must be satisfied and the other general limitations still apply [s DB 56].

990.20 Prohibition on deduction by employees [s DA 2(4)]

No deduction for motor vehicle expenses or depreciation is available to the extent that they are incurred in deriving income from employment. Thus, employees using their private cars to travel to and from work are unable to claim deductions for motor vehicle expenses or depreciation.

990.25 Apportionment [ss DE 2, DE 3]

If a motor vehicle is used by a taxpayer partly for business purposes and partly for other purposes, only the proportion of the total motor vehicle expenditure (including depreciation) that relates to the business use may be claimed as a deduction. Section DE 2 supplements the general permission, and overrides the private limitation.

The amount of the deduction allowed in an income year for motor vehicle expenditure for the business use of the vehicle is determined by the formula:

\[
\text{expenditure} \times \text{business proportion}
\]

Where “business proportion” is the business use proportion calculated under ss DE 3 to DE 12.

In relation to depreciation, ss DE 2(5) and (8) provide for the amount of depreciation loss and depreciation loss on disposal respectively. In relation to depreciation, the amount of depreciation loss that can be claimed is:

\[
\text{standard calculation} \times \text{business proportion}
\]

Where:

“Standard calculation” is the depreciation loss amount determined under the depreciation rules [s EE 16].
“Business proportion” is the business use proportion for the income year, which will be the same proportion as that used for motor vehicle expenses.

If on sale or disposal of a vehicle there is a depreciation loss, the amount of the disposal depreciation loss is determined in accordance with the following formula:

\[
\text{disposal depreciation loss} \times \text{all deductions} / (\text{base value} − \text{adjusted tax value})
\]

Where:

“Disposal depreciation loss” is the amount resulting from a calculation made under s EE 48(2), which is the standard rule for determining a depreciation loss on disposal.
“All deductions” is the amount of all deductions for depreciation loss for the vehicle that have been deducted in each of the income year in which the person has owned the vehicle.

“Base value” and “adjusted tax value” have their ordinary meanings [see 250.120].

If an amount of depreciation recovery income arises on sale, this is calculated under s EE 49 [see 250.500]. Depreciation is further discussed at 990.70 and 990.75.

The methods for determining the business proportion are set out in s DE 3, which are:

(a) Maintaining actual records of business use [s DE 5, see 990.30]; or
(b) Keeping a logbook of business use for a three-month test period every three years [ss DE 6 to DE 11, see 990.35].
(c) Using mileage rates [s DE 12, see 990.65].

If a motor vehicle is not used for any purpose other than deriving income (ie there is no private or other non-business use) or providing a fringe benefit, then no apportionment is required. Similarly, no apportionment is required if the taxpayer is a company or a person whose sole income is income from employment. Companies are not required to apportion motor vehicle expenditure because any non-business use of company motor vehicles will be subject to FBT or will give rise to a non-cash dividend. There is no need for employees to apportion motor vehicle expenditure because they are unable to claim any deductions for such expenditure incurred in gaining income from employment [s DA 2(4)]. This effectively means that only self-employed individuals (including partners in a partnership) are required to apportion their motor vehicle expenditure.

### 990.30 Default method for calculating business use [s DE 4]

If a person has not maintained adequate actual records to show the proportion of business use, the period is not a period covered by a logbook, or the person is not eligible to use the mileage rate method, the business use proportion for the purposes of the deductions under s DE 2 (for motor vehicles expenses and depreciation) is the lesser of:

(a) The proportion of actual business use of the vehicle; or
(b) Twenty-five per cent of the total use of the vehicle.

If there are no records that can be used to establish actual business use, no deduction will be allowed [see TIB vol 6:3 (September 1994) at 10].

### 990.35 Use of actual records to establish business use [s DE 5]

One option for determining the business use proportion of a motor vehicle is for the taxpayer to keep a record of all business trips made in the vehicle during the income year. The taxpayer must maintain a complete and accurate record of the reasons for and the distances of all business trips. The business use proportion for the income year is the total distance of all business trips during the year divided by the total distance travelled by the vehicle during the year.

This method of determining the business use proportion may not be used during a logbook application period, except with the agreement of the CIR.

### 990.40 Using logbook for test period [ss DE 6, DE 7 and DE 8]

Another option for determining the business use proportion of a motor vehicle is for the taxpayer to keep a logbook for a three-month test period. Once the business use proportion has been established, the business use proportion applies for a logbook term, which is a three-year period, as defined in s DE 8 and discussed below.

When a logbook is used to establish the proportion of business use of a motor vehicle, a person must select a start date, and keep the logbook for at least 90 consecutive days at a time that represents (or is likely to represent) the average proportion of business travel in the vehicle during the logbook term. A record of the total distance travelled during each income year that falls within a logbook term. Maintaining a logbook to establish the proportion of business use does not remove the requirement to keep records verifying the expenditure incurred by the taxpayer.
A logbook must record the:
(a) Start and end of the 90-day test period;
(b) Vehicle’s odometer readings at the start and end of the test period;
(c) Distance of each business journey;
(d) Date of each business journey;
(e) Reason for each business journey; and
(f) Any other detail that the CIR may require.

The “logbook term” is the period for which the business use proportion established by a logbook will be used for apportioning motor vehicle expenses. The logbook term cannot exceed three years.

The logbook term starts on the latest of the following days:
(a) First day of the income year in which the taxpayer starts to keep the logbook;
(b) Day on which the motor vehicle (not being a replacement motor vehicle) was acquired;
(c) Day immediately after the last day of the previous logbook term;
(d) A day specified by the taxpayer.

The logbook term ends on the earliest of the following days:
(a) Day that a person disposes of the motor vehicle without replacing it;
(b) Day that is three years after the first day of the income year in which the logbook term started; 
(c) A day specified by the CIR under s DE 9; or
(d) A day specified by the taxpayer.

With the approval of the CIR, a taxpayer may maintain full records [see 990.35], over any period during which business use is not representative of the average (ie a period of temporary and unforeseen increase in business activity) [see TIB vol 6:3 (September 1994) at 10].

**Example:**
John starts business as a sole trader on 1 April 20X1 and uses the secondhand car he acquired on 13 January 20X1. He starts keeping a logbook for a 90-day test period on 4 April 20X1. The test period establishes that the vehicle is used for business purposes for 60 per cent of the total distance travelled. The business does well and John upgrades his car on 25 November 20X1. The new car is to be used in exactly the same way as the old one. In early 20X2 John realises that he is using his car a lot more for work purposes, so he decides to end the current business use apportionment on 4 February 20X2 and start another logbook test period. This time the test period shows that the vehicle’s business use is 80 per cent.

The initial logbook term will start on 1 April 20X1, which is the beginning of the income year in which John started to keep a logbook for a test period after the vehicle had been purchased. Although John changed cars on 25 November 20X1, the new vehicle is used in a similar manner to the old one so the logbook term can continue [see 990.50]. The initial logbook term will end on 4 February 20X2 because John specified this date.

The second logbook term will start on 5 February 20X2, being a date specified by John, and (unless there is any other relevant change in circumstances) will end on 31 March 20X4, being a date not more than three years after the beginning of the income year in which the logbook term started under s DE 8(3)(b). To calculate the proportion of deductible motor vehicle expenses for the 20X1-2X2 tax year, a weighted average of the business use determined in both logbook terms must be calculated. The calculation should be based on the number of days each logbook term applied during the income year. The calculation is as follows:

\[
\text{20X1-X2 business use} = \frac{[307 \times 60\%]}{365} + \frac{[58 \times 80\%]}{365} = 63\%
\]

Example adapted from TIB vol 6:3 (September 1994) at 11.

**990.45 Variance during logbook term [s DE 10]**

A logbook term must end on the last day of any month during which the actual business use proportion of a motor vehicle is less than the business use proportion established by the logbook by 20 percentage points or more, and the business use proportion established by the logbook no longer fairly represents the average business use proportion for that vehicle.
Example:
If the business use of a motor vehicle drops from 50 per cent (as calculated from the logbook test period) to 30 per cent during July, the logbook term will end on 31 July. However, if the change in use is of short duration or the taxpayer elects to keep full records for the abnormal period, the enforced ending will not apply [see TIB vol 6:3 (September 1994) at 10].

990.50 Application of logbook to replacement vehicle [s DE 11]
For the purposes of establishing the proportion of business use of a motor vehicle, a logbook continues to apply to any replacement vehicle in the same manner as it applied to the vehicle that was replaced, provided it is likely to be representative of the average travel for business purposes for the remainder of the logbook term. A record must be kept of the total distance travelled by the replacement vehicle during each income year that falls within the remainder of the logbook term from the time it was replaced.

990.55 CIR’s powers of veto [s DE 9]
The CIR, if not satisfied that the logbook is representative of the average travel for business and non-business purposes, may either:
(a) Specify another 90-day period within the logbook term in which the person is to keep a further logbook; or
(b) Treat the person as not having kept a logbook that applies to the logbook term.
If the CIR directs that a further logbook be kept under (a) for the logbook term, and the proportion of business use calculated under that further logbook is less by at least 20 per cent than the proportion calculated under the first logbook, the CIR may find that the first logbook:
(a) Represented the average business use of the motor vehicle for business purposes for only part of the logbook term; or
(b) Did not represent that business use at all.
In the case of (a), the CIR may determine a date on which the application of the first logbook ended, and the further logbook applies to a new logbook term that starts on the day after that date.
In the case of (b), the CIR may direct that the further logbook applies for the logbook term to which the first logbook applied.

990.60 Vehicle logbooks — required content and quality
Taxpayers who use a vehicle for business and private purposes usually record details of vehicle use in a logbook. The logbook establishes the proportion of business to private use. This proportion may be used:
(a) To apportion vehicle running costs and depreciation for income tax;
(b) To determine whether a vehicle is used principally in the making of taxable supplies for GST;
(c) To calculate private use adjustments for GST; and
(d) In some cases, to determine the number of days each quarter the vehicle is available for private use and enjoyment for FBT purposes.
Inland Revenue notes that many taxpayers, although maintaining a logbook, do not record the required details and that many logbooks are illegible or incomplete. When reviewing a logbook the CIR must be satisfied that the business use proportion established by the logbook during the 90-day logbook test period is representative of the three-year logbook term. If the logbook is incomplete, illegible, or does not record the required details, the CIR cannot form such an opinion. In these circumstances the CIR has the discretion to either require another logbook to be maintained for another 90-day period or to deem the taxpayer not to have maintained a logbook for the three-year logbook application period.
The consequences of not maintaining an adequate logbook could include:
(a) Being required to maintain another logbook for 90 days;
(b) Having income tax deductions for running costs and depreciation limited to 25 per cent;
(c) Having GST input tax claims for the purchase of motor vehicles disallowed or delayed for three months; or
(d) Having FBT assessed as if the vehicle was available for private use and enjoyment on every day.

Inland Revenue requires the following information to be recorded in a logbook, in a legible and understandable format:
(a) The start date of the 90-day logbook test period;
(b) The odometer reading at the start of the 90-day logbook test period;
(c) The date of each business journey;
(d) The starting odometer reading for each business journey;
(e) The ending odometer reading for each business journey;
(f) The origin and destination of each business journey;
(g) The reason for each business journey;
(h) The time of each business journey when the use of the vehicle is subject to time constraints;
(i) The end date of the 90-day logbook test period; and
(j) The odometer reading at the end of the 90-day logbook test period.

Example 1 (below) illustrates a logbook containing this information.

Alternatively, logbooks can record all journeys (business and private), whether the journey was business or private, and just record the starting or ending odometer reading for each journey rather than both. Example 2 (below) illustrates a partial logbook containing this information.

Inland Revenue expects that most business journeys recorded in logbooks should be verifiable by reference to other records, such as diaries, appointment books, quotes, and invoices.

Inland Revenue does not require that logbooks be kept in any particular format. The examples below use a columnar format, but the required details could be recorded in a diary, in a daybook, or on quote or order forms. Whatever format is used, Inland Revenue must be satisfied that the records are complete and accurate and that the required details have been kept.

The ITA 2007 does not specify how the information required in the logbook is to be recorded. If a taxpayer finds it easier in the first instance to record on a dictaphone the business kilometres travelled, this will be acceptable to Inland Revenue provided the information in the logbook complies with s DE 7 and is transcribed into the logbook. A taxpayer electing to record information on a dictaphone will need to safeguard the tape against loss or damage until its contents are transcribed to the logbook, because without this information claims could be jeopardised [see TIB vol 6:13 (May 1995) at 17].

At the end of the 90-day logbook test period the following calculation should be performed to determine the business use percentage for the vehicle:

$$\text{business use percentage} = \frac{\text{total business distance travelled}}{\text{total distance travelled}}$$

Inland Revenue expects the totals used in this calculation to be easily reconciled with the entries in the logbook.

Example 1:

VEHICLE LOGBOOK

Vehicle description: Ford Fairmont

Vehicle registration number: XX1234

<table>
<thead>
<tr>
<th>Date</th>
<th>Time</th>
<th>Start kms</th>
<th>End kms</th>
<th>Distance</th>
<th>Journey</th>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Feb X1</td>
<td></td>
<td>65423</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10 Feb X1</td>
<td>9.08 am</td>
<td>65423</td>
<td>65555</td>
<td>132</td>
<td>Office - Mr Hammer - office</td>
<td>Quote</td>
</tr>
</tbody>
</table>
### Example 2:

**VEHICLE LOGBOOK**

Vehicle description: Mini

Vehicle registration number: XX1235

<table>
<thead>
<tr>
<th>Date</th>
<th>Time</th>
<th>Start kms</th>
<th>End kms</th>
<th>Distance</th>
<th>Bus/Pvt</th>
<th>Journey</th>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 Mar X1</td>
<td>8 am</td>
<td>150265</td>
<td>150268</td>
<td>3</td>
<td>Pvt</td>
<td>Home - office</td>
<td></td>
</tr>
<tr>
<td>15 Mar X1</td>
<td>9 am</td>
<td>150268</td>
<td>150270</td>
<td>42</td>
<td>Bus</td>
<td>Office - airport - office</td>
<td>Collect samples</td>
</tr>
<tr>
<td>15 Mar X1</td>
<td>12.05 pm</td>
<td>150310</td>
<td>150316</td>
<td>6</td>
<td>Pvt</td>
<td>Office - home - office</td>
<td></td>
</tr>
<tr>
<td>15 Mar X1</td>
<td>2 pm</td>
<td>150316</td>
<td>150320</td>
<td>4</td>
<td>Bus</td>
<td>Office - bank - office</td>
<td>Banking</td>
</tr>
<tr>
<td>15 Mar X1</td>
<td>2.30 pm</td>
<td>150320</td>
<td>150390</td>
<td>70</td>
<td>Bus</td>
<td>Office - JT Ltd - office</td>
<td>Deliver samples</td>
</tr>
<tr>
<td>15 Mar X1</td>
<td>4.45 pm</td>
<td>150390</td>
<td>150393</td>
<td>3</td>
<td>Pvt</td>
<td>Office - home</td>
<td></td>
</tr>
<tr>
<td>15 Mar X1</td>
<td>Ending</td>
<td>150393</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Business use percentage = Total business distance travelled / Total distance travelled

= 90.6% / (150393 – 150265) = 90.6%

**Note:** The logbook in Example 2 was maintained only for one day for illustrative purposes. Actual logbooks must be maintained for the 90-day logbook test period.

For Inland Revenue’s requirements as to the required content and quality of logbooks kept to establish the business use of a motor vehicle [see TIB vol 7:8 (February 1996) at 29-31].

### 990.65 Mileage rate method [s DE 12]

Mileage rates may be used to calculate the business-use expenditure on a motor vehicle if a person’s business travel is 5,000 kilometres or less in an income year. A person wanting to use the mileage rate method must keep details of the business use of the vehicle and calculate the total distance (in kilometres) travelled for business purposes during the income year. The amount of the deduction is calculated by multiplying the applicable mileage rate by the total number of kilometres travelled for business purposes for the income year. The CIR is required to set and publish a mileage rate from time to time.

**Income year Mileage rate**

<table>
<thead>
<tr>
<th>Year</th>
<th>Mileage rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010-2011</td>
<td>74 cents per kilometre</td>
</tr>
<tr>
<td>2009-2010</td>
<td>70 cents per kilometre</td>
</tr>
</tbody>
</table>
The mileage rate applies to self-employed persons for work-related travel not exceeding 5,000 km a year. The mileage rate applies to all motor vehicles (excluding motorcycles) irrespective of engine size, or whether they are powered by petrol or diesel.

The mileage rate may also be used as a reasonable estimate by employers reimbursing employees (including shareholder-employees) for business use of an employee’s private vehicle, from 1 April 2008. The 5,000 km a year limit does not apply when employers use the mileage rate to reimburse employees.

For distances of greater than 5,000 km a year, actual motor vehicle expenses must be used [see 990.35, 990.40].

Operational statement OS 09/01 [see TIB vol 21:3 (May 2009) at 26-27], which introduced the single mileage rate, replaced any previously published statement by the CIR on motor vehicle mileage rates. For the mileage rates that applied before the 2008-2009 income year, see Staples Tax Guide 2009 990.65

No mileage rate has been set for motorcycles as they are now rarely used for business purposes.

990.70 Depreciation [ss BD 2, DA 4, DE 1, DE 2, DE 3, DE 4, DE 5, DE 6, DE 7, DE 8, DE 9, DE 10, DE 11, DE 12, EE 1(5)]

A deduction for depreciation of a motor vehicle is allowed under s BD 2 if the taxpayer is entitled to such a deduction under s DA 1 or DE 2 and subpart EE, which sets out the detailed depreciation rules. The depreciation rules are explained in 250 DEPRECIATION. A depreciation deduction is only available in respect of a motor vehicle that is owned by the taxpayer and used, or available for use, by the taxpayer.

Under s DE 2, when a motor vehicle is used partly for business purposes and partly for non-business purposes, only the proportion of the total depreciation that relates to business use (as determined under ss DE 3 to DE 12), may be deducted [see 990.25, 990.55].

Motor vehicles (as with all depreciable property) may, at the option of the taxpayer, be depreciated either on a straight-line (SL) basis or a diminishing value (DV) basis [see 250.30]. The depreciation rates for motor vehicles are listed in 5000 DEPRECIATION RATES.

If a motor vehicle is acquired part-way through the taxpayer’s income year, one-twelfth of a full year’s depreciation may be claimed for each part or whole month that the vehicle is owned and used by the taxpayer.

Example:
Sandy is a self-employed engineering consultant. He is GST-registered. His business assets include a station wagon which he bought new at a cost of $35,000 (exclusive of GST) on 1 July 20X1. Sandy kept a vehicle logbook for 90 days ending 30 September 20X1. The logbook recorded that Sandy had driven the vehicle a total of 2,500 km during this 90-day period and that 2,000 km related to business use. The business use proportion is therefore 80 per cent (2,000/2,500). The applicable depreciation rate for a new station wagon is either 21 per cent SL or 30 per cent DV. Assuming Sandy has a 31 March balance date and elects to use the DV rate, his depreciation deductions for the 20X2 and 20X3 income years will be calculated as follows:

20X2
Total depreciation for nine-month period: $35,000 × 30% × 9/12 = $7,875
Allowable depreciation deduction: $7,875 × 80% = $6,300

20X3
Total depreciation for year: ($35,000 − $7,875) × 30% = $8,138
Allowable depreciation deduction: $8,138 × 80% = $6,510

If Sandy elected to calculate his depreciation on an SL basis, the calculations would be as follows:

20X2
Total depreciation for nine-month period: $35,000 × 21% × 9/12 = $5,513
Allowable depreciation deduction: $5,513 × 80% = $4,410

20X3
Total depreciation for year: $35,000 × 21% = $7,350

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**Allowable depreciation deduction:** $7,350 × 80%  
$5,880

**990.75 Gain or loss on disposal of vehicle [ss DE 2(7), (8)EE 11, EE 49]**

When a motor vehicle, in respect of which a depreciation deduction has been claimed, is sold or otherwise disposed of for more or less than its adjusted tax value, the difference will represent either depreciation recovery income or depreciation loss.

In the income year that a motor vehicle is sold or otherwise disposed of, no depreciation deduction is allowed in respect of that vehicle [s EE 11(1)]. However, if the vehicle is sold at less than adjusted tax value, a deduction will be available under s DE 2(8). When sold at an amount greater than adjusted tax value depreciation recovery income arises under s EE 49.

**Example:**

Continuing on from the example in 990.70, assume that Sandy sold his station wagon for $17,000 (exclusive of GST) on 30 April 20X3. Because the vehicle was sold on 30 April 20X3, no depreciation can be claimed in the 20X4 income year. However, Sandy will be able to claim a deduction under s DE 2(8) calculated as follows:

**DV method**

Adjusted tax value at 31 March 20X3 is ($35,000 − $7,875 − $8,138)  
$18,987

Loss on sale (allowable deduction) is ($18,987 − $17,000)  
$1,987

Under the formula in s DE 2(8):

Disposal depreciation loss is:  
$1,987

All deductions is ($6,300 + $6,510):  
$12,810

Base value is $35,000 and adjusted tax value is $18,987. The depreciation loss on disposal is: $1,987 × $12,810 / $16,013 = $1,590. Alternatively, as the business use percentage was 80 per cent the depreciation loss on disposal can be calculated as $1,987 × 0.80 = $1,590.

**SL method**

Adjusted tax value at 31 March 20X3: ($35,000 – $5,513 – $7,350)  
$22,137

Loss on sale is ($22,137 – $17,000)  
$5,137

Under the formula in s DE 2(8):

Disposal depreciation loss is:  
$5,137

All deductions ($4,410 + $5,880) is:  
$10,290

Base value is $35,000 and adjusted tax value is $22,137. The depreciation loss on disposal is: $5,137 × $10,290 / $12,863 = $4,109. Alternatively, as the business use percentage was 80 per cent the depreciation loss on disposal can be calculated as $5,137 × 0.80 = $4,109.

**Note:** Only the business use proportion of the loss (in this example, 80 per cent) may be claimed as a disposal depreciation loss.

If instead the station wagon had been sold for $23,000 (exclusive of GST), the excess of the sale price over the adjusted tax value would be depreciation recovery income for Sandy, calculated under s EE 49 as follows:

**DV method**

Depreciation recovery income: ($23,000 – $18,987).  
$4,013

All deductions is:  
$12,810

Base value is $35,000 and adjusted tax value is $18,987. Amount of depreciation recovery income is: $4,013 × $12,810 / $16,013 = $3,210. Alternatively, as the business use percentage was 80 per cent, the depreciation loss on disposal can be calculated as $4,013 × 0.80 = $3,210.

**SL method**

Depreciation recovery income is ($23,000 – $22,137):  
$863

All deductions is ($4,410 + $5,880):  
$10,290

Base value is $35,000 and adjusted tax value is $22,137. Amount of depreciation recovery income is: $863 × $10,290 / $12,863 = $690. Alternatively, as the business use percentage was 80 per cent, the depreciation recovery income is $863 × 0.80 = $690.

**Note:** Only the business use proportion of the gain is depreciation recovery income.
990.80 Registration plates bought as an investment

The income tax consequences of acquiring vehicle registration plates as an investment (not as a personalised number plate), are as follows:

(a) If the taxpayer buys and sells vehicle investment plates as part of a business of trading in those items, any gain on sale would be assessable income under s CB 1 or CB 5. If the taxpayer is in business, the plates will likely constitute trading stock. This means they must be brought in as stock on hand at the end of the year, and be valued according to the rules as set out in 1400 TRADING STOCK.

(b) If the taxpayer is not in business, but the plates were acquired for the purpose of eventually selling them at a profit, any amount received on sale would be assessable income under s CB 4. Inland Revenue’s view is that it would be difficult to see any other reason for acquiring an investment plate, other than for eventual sale at a profit. As there is no other income stream associated with the purchase, the onus would be on the taxpayer to demonstrate that the “investment” was not purchased with the intention of resale. If s CB 4 applies, the cost of the property will be allowed as a deduction under s DB 23, which, as it is subject to subject to s EA 2, will arise in the year of sale.

A deduction will be allowed under s DA 1 for any other expenses in the year incurred (eg insurance of the plates in the year the expense is incurred) [see TIB vol 10:5 (May 1998) at 24].

990.85 Motor vehicle dealers — deductions

Motor vehicle dealers must keep a logbook for any motor vehicle not used 100 per cent for business purposes so that the deductible proportion of expenses can be correctly identified.

The CIR has ruled that motor vehicle dealers can use the following approach to ascertain deductible vehicle expenses:

\[
\text{private vehicle expenses} = \frac{PR}{TR} \times N \times AE
\]

Where:

- \( PR \) is private running (in km);
- \( TR \) is total running (in km) in vehicles used privately;
- \( N \) is number of vehicles used privately; and
- \( AE \) is average expenses per vehicle (ie total vehicle expenses / total vehicles owned in the year).

Total vehicle expenses includes petrol and oil but not repairs, tyres and registration.

\[
\text{deductible vehicle expenses} = \text{total vehicle expenses} - \text{private vehicle expenses}
\]

Motor vehicle dealers may exclude repairs, tyres and registration expenses incurred when applying the formula because it cannot be argued that these types of expenses, carried out by a motor vehicle dealer to bring a secondhand vehicle to a suitable condition for sale, are incurred for the private running of the vehicle by the motor vehicle dealer. Only those expenses (if any), that can be directly attributed to private running (eg repairs following an accident that occurs while the vehicle is being used privately by the motor vehicle dealer) are included in the calculation.

Ideally, the motor vehicle dealer should identify a vehicle that is used privately and then keep a log of business running from the day the particular vehicle is purchased until it is sold.

Alternatively, the motor vehicle dealer could keep a log of business running once a vehicle is first used for private use. The following example illustrates how private and business running is ascertained by this method.

<table>
<thead>
<tr>
<th>Example:</th>
<th>Odometer running km</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vehicle purchased 1 April 20X1</td>
<td>20,000</td>
</tr>
<tr>
<td>Vehicle first used privately 1 June 20X1</td>
<td>20,500</td>
</tr>
<tr>
<td>Vehicle sold 1 September 20X1</td>
<td>26,000</td>
</tr>
</tbody>
</table>

(A logbook of business running is kept from 1 June 20X1 until the vehicle is sold.)
Private running calculation:
Odometer (26,000 − 20,500) 5,500
Less business running (as per logbook) 2,000
Private running 3,500

Business running calculation:
Odometer reading when vehicle purchased 20,000
Odometer reading as at 1 June 20X1 20,500
Difference 500
Plus business running (as per logbook) 2,000
Business running 2,500

[see PIB 159 (February 1987) at 3-4].

990.90 Fringe benefit tax

When an employer makes available a motor vehicle for the private use of an employee, the employer may be liable to pay fringe benefit tax (FBT). This applies only to motor vehicles with a gross laden weight of 3,500 kg or less. In addition, there are exemptions for work-related vehicles and for vehicles used for emergency callouts or for out-of-town business trips. The circumstances in which the use of a motor vehicle gives rise to an FBT liability and the method for calculating that liability are explained in 540.60 and 540.110.

If the supply of a motor vehicle constitutes a fringe benefit a record must also be kept of any days on which the vehicle is not available for private use or has been used for an emergency callout. This record is normally incorporated into the records explained in 990.30 and 990.35.

990.95 Tax planning considerations

Motor vehicles are frequently the focus of tax planning activity in businesses because:

(a) Motor vehicles are a common business asset and often constitute a significant proportion of the total value of the assets of a business.

(b) The cost of operating motor vehicles may be a significant business expense.

(c) Motor vehicles are an “attractive” item and as such are often made available to employees and shareholders.

(d) The private use of motor vehicles by employees (including shareholder-employees) gives rise to an FBT liability.

(e) It is very easy to switch between business and private use of motor vehicles.

Much of the tax planning effort in relation to motor vehicles involves attempts to minimise the exposure to FBT. In the past, motor vehicle lease arrangements were used to reduce exposure to FBT. However, recent tax law changes have largely removed this option [see 540.60 and 540.115].

Motor vehicles may be “acquired” as business assets in a number of different ways including outright purchase, hire purchase, operating lease, and finance lease. See 900 LEASED ASSETS for a general discussion of the tax implications of leasing. Another alternative is for employers to reimburse the running costs of vehicles owned by employees or shareholder employees. Each option has different tax consequences which can be quite complex, involving income tax, FBT and GST considerations.

Example:
A company has two shareholders and directors who are a married couple. The husband is employed by the company. For some years the company leased four motor vehicles for use in its business. The husband then decided to purchase four motor vehicles privately and lease them to the company at market rates. As a shareholder-employee, can he claim depreciation on the leased vehicles? Under s EE 1, a person is allowed a deduction for an amount of depreciation loss if the provisions of Part D are met. As the shareholder-employee incurred the depreciation expense as a result of leasing the motor vehicles to the company, the expense is deductible because the depreciable property owned is used in deriving assessable income [ss EE 6 and EE 7 define...
“depreciable property”). Although the shareholder is an employee of the company, he is also in the business of leasing motor vehicles [see TIB vol 6:3 (September 1994) at 16].
Chapter 1000
Non-residents and Absentees

1000.10 Definitions

An “absentee” is defined as “a person other than a person who is resident in New Zealand during any part of the tax year” [s YA 1]. A “non-resident” is defined as a person who is not a New Zealand resident [see 1250 RESIDENCE].

It follows that an absentee is always a non-resident, but a non-resident is not necessarily an absentee. A non-resident is only an absentee through being a non-resident for a full tax year. In the definition of resident a person may be a non-resident and still be in New Zealand for short periods during the tax year. The tax impositions for non-residents generally apply also to absentees except that absentees are generally not permitted to claim certain personal tax credits in calculating income tax [1000.35].
Non-residents and Absentees

1000.15 Income derived from New Zealand by non-residents

When income is derived from New Zealand and comprises dividends from New Zealand companies, or interest paid to a non-associated person or cultural royalties, the New Zealand tax liability on that income (referred to as non-resident passive income) is generally satisfied in full by the non-resident withholding tax (NRWT) deducted by the payer in New Zealand [see 1020 NON-RESIDENT WITHHOLDING TAX]. Income derived from New Zealand (other than non-resident passive income) is liable to New Zealand tax at normal resident rates and the non-resident is required to file an individual’s income tax return for income other than non-resident withholding income. Where a non-resident company derives income from New Zealand via a branch in New Zealand, then it is taxed at 30 per cent, the same as for resident companies.

1000.20 Personal services of non-resident visitor employed by a resident

Where a non-resident visits New Zealand for a short period of time that is not sufficient to become a resident and derives salary and wages, limitations may apply to the imposition of income tax on the income derived in the form of salary and wages. Income derived from personal services supplied in New Zealand to, or for, the benefit of a New Zealand employer is subject to ordinary income tax being imposed according to the PAYE system [ss BD 1(5), CE 1, RA 5, subpart RD]. The employer may need to obtain a clearance to employ the non-resident through the immigration authorities.

Non-resident seasonal workers are treated as residents for income tax purposes even if their stay in New Zealand exceeds 183 days in a 12-month period. The earnings of such workers are taxed at a flat rate of 15 per cent [see 1080.31].

1000.25 Personal services of non-residents visiting New Zealand and employed by a non-resident [s CW 19]

A non-resident who is employed by a non-resident for personal services performed in New Zealand is exempt from New Zealand income tax in the following circumstances:

(a) The duration of the visit does not exceed 92 days; and
(b) The total number of days that the person is present in New Zealand during the tax year does not exceed 92; and
(c) The income is chargeable with tax, which is substantially the same as income tax, in the country of residence of the visitor; and
(d) The services are performed for and on behalf of an employer who is not resident in New Zealand.

The exemption does not apply to public entertainers (ie theatre, motion picture, television, and radio artists, singers, musicians, dancers, lecturers, circus performers, athletes, boxers, wrestlers, and other professional sports people).

Example:

(a) Marie’s first visit to New Zealand from 24 March to 5 May 20X1 is 43 days (eight days in one income year and 35 in the next). No tax liability, as the visit is less than 92 days.
(b) Marie’s second visit to New Zealand from 1 June to 20 July 20X1 is 50 days. No tax liability, as the visit (plus 35 days of the first visit) is less than 92 days.
(c) Marie’s third visit to New Zealand from 21 March to 15 July 20X2 is 117 days (11 days in one income year and 106 in the next). She is liable for tax on the whole of the income from New Zealand during the year ended 31 March 20X2 as the number of days present during the year was 96 days, made up of 35 days in (a), 50 days in (b), and 11 days in (c).

Marie would also be liable for tax on income from New Zealand for the period from 1 April to 15 July 20X2 as the third visit in itself also exceeds 92 days, thus excluding the whole of the income of that visit from the exemption. In other words, if this had been the only visit in the year ended 31 March 20X3, the whole of the income earned on this trip would still have been subject to tax in New Zealand.

Inland Revenue policy is that tax deductions must be made in the usual way from salaries paid in New Zealand by a non-resident company to personnel normally resident abroad but working temporarily here for the company.

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It may not be possible to determine in advance whether the visiting non-resident will stay longer than the exemption period. Inland Revenue may accept a bond or other form of security from an employer to cover PAYE on non-resident employees in situations where their liability to tax in New Zealand is uncertain [s RD 23]. Where a bond or other security is provided, an employer must not:

(a) Make PAYE deductions for non-resident employees;
(b) Include information regarding non-resident employees in an employer monthly schedule; or
(c) Apply the non-declaration rate to a source deduction payment made to non-resident employees, until they become liable to tax in New Zealand or Inland Revenue specifies a date from which tax deductions are to be made. After that the employer is then liable for any PAYE incurred in the period covered by the bond.

Alternatively, Inland Revenue may require PAYE to be deducted as an interim measure. If, at the end of the visit, it is apparent that there is no New Zealand tax payable (because the employee stayed for a period within the exemption period) the tax deductions will be refunded.

The foregoing rules apply when no double tax agreement [see 1000.30] exists between New Zealand and the visiting non-resident’s country of residence.

**1000.30 Personal services of non-residents visitor employed by a resident from a double tax agreement country**

All of the double tax agreements to which New Zealand is a party provide for an exemption period of 183 days for non-resident visitors working in the other country. Generally, income derived in New Zealand from dependent personal and professional services by a non-resident individual is exempt under the relevant double tax agreement (DTA) where:

(a) The individual is present in New Zealand for less than 183 days in any 12-month period (earlier agreements refer to an income year or taxation year);
(b) The remuneration is paid by or on behalf of an employer who is resident in the other country; and
(c) The remuneration is not borne by a permanent establishment or fixed base that the person has in New Zealand.

However, the specific rules vary from agreement to agreement, and care should be taken to refer to the agreement itself before taking a tax position [see 310 DOUBLE TAX AGREEMENTS].

**1000.35 Absentees entitled to some tax credits** [s LC 9]

An absentee who has derived assessable income from their personal services while they are personally present in New Zealand, and who would be entitled to a tax credit under ss LC 3 to LC 6 if they were not an absentee, has a tax credit as calculated by the following formula:

\[
\text{Credit amount} \times \frac{\text{days}}{365}
\]

Where:

“Credit amount” is the tax credit the person would be entitled to if they were not an absentee;

“Days” is the total number of days in the tax year for which the person is paid for the personal services.

The tax credits to which this applies are the:

(a) Tax credit for school children [s LC 3];
(b) Transitional tax credit [ss LC 4, LC 5]; and
(c) Housekeeper tax credit [s LC 6].

When calculating the transitional tax credit for an absentee, their income is first grossed up to its full year equivalent (as required by s LC 11). The tax credit is calculated on this grossed up amount and then apportioned on the basis of the number of weeks (if the absentee was paid for regular pay periods) or days the absentee was present in New Zealand [see TIB vol 5:2 (August 1993) at 5, 6]. If income is derived from
a business carried on in New Zealand and the absentee derives no income from personal services here in the same income year, the income is assessable in full without tax credits [see 1395 TAX CREDITS].

1000.40 **Personal services of non-resident company director** [s YD 4(4)]
The liability of a non-resident on emoluments received from a New Zealand resident generally depends on whether the non-resident has been personally present in New Zealand while earning the income. Income treated as having a source in New Zealand includes an amount that is income under s CE 1 (amounts derived in connection with employment), if the amount is earned in New Zealand, even if the employer is not resident in New Zealand.

It follows that a non-resident director of a New Zealand company who does not visit New Zealand incurs no liability to New Zealand tax on director’s fees received. However, a director visiting New Zealand would be considered to earn in New Zealand the proportion of the annual director’s fee which the stay in New Zealand bears to the days in the income year for which the director’s fee is paid. Qualifying tax credits may also be proportioned on a daily basis.

1000.45 **Non-resident self-employed contractor**
Where the non-resident is an independent self-employed contractor (ie a consultant, artist, etc), it is appropriate to claim expenditure incurred in carrying on a business in the same way as other self-employed people [s DA 1]. Taxpayers who are employed by another are not able to claim expenses relating to employment [s DA 2(4)]. Payments made to non-resident contractors, which constitute schedular payments, are subject to tax deductions [see 1320.20].

1000.50 **Personal services of non-resident entertainers and professional sports persons** [ss CE 1, CW 19, CW 20, sch 4]
Visiting professional entertainers and sports people are liable to taxation on salary or wages derived from employment whether they are employed by a resident or a non-resident [ss CE 1, YD 4(4)]. The normal relief provisions for short visits by non-residents who are employed by non-residents do not apply as the exemption specifically excludes professional entertainers and sports people [s CW 19]. The special provisions of many double tax agreements (DTAs) for the right to tax artistes and athletes generally override the “183 day clause” for salaried employees so that such employees may be liable to New Zealand tax on all remuneration earned in New Zealand. A liability then exists for all salary or wages earned while in New Zealand and all profits from any business carried on in New Zealand [s YD 4].

Payments made to a non-resident entertainer (or to an agent or person acting on their behalf) are subject to a withholding tax at the rate of 20 cents in the dollar when the payment is for any of the following:

(a) A performance at a sporting event or competition;
(b) Making a speech or giving a lecture or talk for any purpose; or
(c) Acting, singing, playing music, dancing or entertaining generally, for any purpose and whether or not alone.

However, no tax deduction is required if the person:

(a) Is fully or partly sponsored under a cultural programme of an overseas government or the Government of New Zealand;
(b) Is an official representative of a body that administers a game or sport in an overseas country; or
(c) Is undertaking an activity or performance under an overseas programme for the promotion of a cultural activity and is not for an individual profit of a member or shareholder [see sch 4, Part F, cl 4].

The 20 per cent withholding tax is the final liability on incomes from activities described in these categories, and the non-resident is under no obligation to furnish a tax return unless the non-resident derives other income from New Zealand. An annual return may be submitted to claim allowable deductions.
When they elect to furnish a tax return the visiting entertainers or professional sports persons may claim against their New Zealand income travelling expenses to and from New Zealand on the following basis:

\[ \frac{\text{NZ Income}}{\text{Total Income}} \times \text{Travelling Expenses} \]

(1) **Exempt income of visiting entertainers** [s CW 20]

Income derived by a non-resident entertainer from an activity or performance in New Zealand during a visit is exempt income if the activity or performance occurs:

(a) Under a cultural programme of the New Zealand Government or an overseas government;
(b) Under a cultural programme wholly or partly sponsored by the New Zealand or an overseas government; or
(c) As part of a cultural programme of an overseas foundation, trust or other organisation that:
   (i) Exists wholly or partly to promote cultural activity; and
   (ii) Is not carried on for the private pecuniary profit of any member, proprietor or shareholder [s CW 20(1)].

Income derived by a non-resident entertainer from an activity that relates to a game or sport in New Zealand during a visit is exempt income if the participants are the official representatives of a body that administers the game or sport in an overseas country [s CW 20(2)]. Exempt income as outlined above is also exempt when provided by a person (eg a company) who:

(a) Provides the services of the non-resident entertainer during the visit to New Zealand; and
(b) Is the entertainer’s employer, a company of which the entertainer is an officer, or a firm of which the entertainer is a principal [s CW 20(3)].

A “non-resident entertainer” is a non-resident person who carries on an activity or performance in connection with:

(a) A solo or group performance by actors, comperes, dancers, entertainers, musicians, singers, or other artists for cultural, educational, entertainment, religious or other purposes;
(b) Lectures, speeches or talks for any purpose; or
(c) A sporting event or competition of any nature.

(2) **Effect of double tax agreement**

The liability of a non-resident entertainer can be affected by the double tax agreement (DTA) that may be in force between New Zealand and the country of the entertainer’s normal residence. The double tax agreements generally give New Zealand the right to tax income derived by public entertainers in New Zealand. Further, when the services of a non-resident artiste or sportsperson are provided by a service company, the agreements generally deem the service company to have a permanent establishment in New Zealand with a consequent liability to New Zealand tax on the profits derived by the non-resident company from the performances of the artiste or sportsperson in New Zealand. However, certain agreements exclude activities of entertainers or athletes where the visit is largely supported by public funds [see 310 DOUBLE TAX AGREEMENTS].

The general effect of a DTA is to set down rules whereby a resident of one state carrying on business in the other state is liable to tax in the other state only so far as industrial or commercial profits (which would include business profits of the professional entertainer) arise from a “permanent establishment”.

The agreements follow a pattern in that one article sets down the precise activities which constitute a “permanent establishment” and another article provides that only those “industrial or commercial profits” attributable to the “permanent establishment” are taxable in the country where the “permanent establishment” exists.
1000.55  Non-residents deriving superannuation or pensions

Income derived by either a resident or a non-resident from a superannuation fund [see 1390.15] or an annuity paid from a life insurance fund of a company is not assessable [s CW 4]. However, a non-resident who derives income from New Zealand from a pension, or a retiring allowance for past employment (or the past employment of a spouse [see 960.10], child, or dependant) is assessed on the income [s CF 1(1)(g)]. No exemptions or tax credits apply unless specifically provided for under a double tax agreement (DTA).

1000.60  Non-resident venture capital investors [ss CW 12, CW 13]

Non-resident investors who provide equity capital to unlisted New Zealand resident companies are exempt from income tax on profits arising from the sale of shares in those companies, provided the company’s main activity is not a prohibited activity. The objective of the exemptions is to encourage foreign equity investment in new business ventures in New Zealand. The exemption includes investments made alongside the New Zealand Venture Investment Fund Ltd [see 370.30].

1000.65  Non-resident traders [ss HD 18, HD 19, HD 20, HD 26, HD 29, YD 5]

Income tax is imposed on a non-resident trader when an agent is instrumental in obtaining business in New Zealand for that principal. It is immaterial whether the contract of purchase is made in New Zealand or elsewhere or whether the agent in New Zealand actually writes the order. The agent must file tax returns of the income derived from the business done in New Zealand and is held liable for the payment of the tax but has a right of recovery from the principal.

The method of assessment adopted is to take a determined percentage of the “gross proceeds” (or sales) of the business as being the net profit derived. The percentage varies with the class of goods dealt in, and is in the first instance an arbitrary method of assessment only. An alternative method to establish income is to submit a profit and loss account of the business done in New Zealand bearing a certificate of a chartered or certificated accountant stating that, in arriving at the net profit or loss disclosed, no charges, either actual or estimated, have been made for interest on capital, reserves, unusual depreciation, or other extraordinary charges. If this cannot be done, a further alternative is for a chartered accountant’s certificate on the same lines of the net profit to turnover on the whole world business and then applying this percentage to the gross proceeds of business done in New Zealand. No special exemption or tax credits are deducted from the net profit at this point. The tax is imposed at the same rates as those applying to residents of New Zealand.

Circumstances may exist when:

(a) The business of a person is carried on partly in New Zealand and partly outside New Zealand; or
(b) A contract is made in New Zealand and is wholly or partly performed by a person outside New Zealand; or
(c) A contract is made outside New Zealand and is wholly or partly performed by a person in New Zealand.

In such cases, the gross amount of income from the business or contract, and the expenditure incurred in deriving the income, is apportioned between New Zealand and sources outside New Zealand. This is done in such a way and to such an extent as is necessary to produce an amount of net income or net loss for the business or contract which the person might be expected to derive if such activities in New Zealand were carried out by a separate and wholly independent person undertaking only those activities and dealing at arm’s length. The person is assessable for income tax accordingly [s YD 5].

If a person in New Zealand (the agent) is instrumental in arranging the purchase of goods from the agent’s non-resident principal, and those goods are in New Zealand or are to be imported into New Zealand under the contract of purchase, then the following apply:

(a) The principal is treated as carrying on a business in New Zealand;
(b) The agent is treated as the principal’s agent in relation to the income derived from the business; and
(c) The income from the business is treated as having a source in New Zealand.
The agent is not liable as agent for the payment of income tax if the CIR is satisfied that in corresponding circumstances in a country outside New Zealand, the principal, if resident in New Zealand, would not be liable for income tax in that country [s. HD 29].

**1000.70 Transfer pricing arrangements** [ss. GB 2, GC 6, GC 7, GC 8, GC 9, GC 10, GC 11, GC 12, GC 13, GC 14]

A person entering into a cross-border arrangement with an associated person for the acquisition or supply of goods, services, or anything else at a consideration which reduces the person’s net income, must substitute an arm’s-length consideration when calculating their net income.

An arrangement is a “transfer pricing arrangement” if:

(a) The arrangement involves the supply and acquisition of goods, services, money, other intangible property, or anything else;

(b) The supplier and acquirer are associated persons; and

(c) The arrangement is a cross-border arrangement.

An arrangement is a cross-border arrangement if:

(a) The supplier and acquirer are a New Zealand resident and non-resident, unless:
   (i) The non-resident enters into the arrangement for the purposes of a business carried on by the person in New Zealand through a fixed establishment in New Zealand; and
   (ii) The New Zealand resident has not entered into the arrangement for the purposes of a business carried on by the person outside New Zealand;

(b) The supplier and acquirer are both New Zealand residents and either or both enter into the arrangement for the purposes of a business carried on by the person outside New Zealand; or

(c) The supplier and acquirer are both non-residents, unless each enters into the arrangement for the purposes of a business carried on by the person in New Zealand through a fixed establishment in New Zealand [s. GC 6].

An adjustment made under any of ss. GC 7 to GC 10 has no effect on an obligation of the taxpayer to withhold an amount under Part R, other than:

(a) An obligation under subpart RG (foreign dividend payments); or

(b) To the extent to which s. GC 11(2) (matching treatment) applies [s. GC 12].

1. **Excess amount payable**

If the amount of consideration payable by a taxpayer under a transfer pricing arrangement is more than an arm’s-length amount, an amount equal to the arm’s-length amount is treated as the amount payable by the taxpayer for the purposes of calculating their tax liability [s. GC 7].

2. **Insufficient amount receivable**

If the amount of consideration receivable by a taxpayer a transfer pricing under an arrangement is less than the arm’s-length amount, then the arm’s-length amount is treated as the amount receivable by the taxpayer for each of the following purposes:

(a) The calculation of their income tax liability for a tax year; or

(b) The determination of the obligation of another person to withhold tax under Part R.

This provision does not apply if the taxpayer was neither resident in New Zealand nor entering into the arrangement for the purposes of a business carried on in New Zealand through a fixed establishment in New Zealand, and:

(a) The amount receivable is a deduction of the other party or, in the case of an interest-free loan, would be a deduction but for the application of subpart FE (thin capitalisation) if an arm’s-length amount of interest were substituted; and
(b) The amount receivable is interest, royalties or an insurance premium to which s YD 8 applies. The provision also does not apply if the amount is a dividend receivable on a fixed-rate share, and the taxpayer is neither resident in New Zealand nor entering into the arrangement for the purposes of a business carried on in New Zealand through a fixed establishment in New Zealand [s GC 8].

(3) Calculation of arm’s-length amount
The arm’s-length amount of consideration must be determined by applying whichever one (or combination) of the methods listed below produces the most reliable measure of the amount completely independent parties would have agreed on after real and fully adequate bargaining. The arm’s-length amount of consideration must be calculated under any one (or combination) of:

(a) The comparable uncontrolled price method;
(b) The resale price method;
(c) The cost plus method;
(d) The profit split method;
(e) Comparable profits methods.

The choice of method or methods for calculation and the resultant application of the method (or methods) must be made having regard to:

(a) The degree of comparability between the uncontrolled transactions used for comparison and the controlled transactions of the taxpayer; and
(b) The completeness and accuracy of the data relied on; and
(c) The reliability of all assumptions; and
(d) The sensitivity of any results to possible deficiencies in the data and assumptions.

The arm’s-length amount of consideration is determined by the taxpayer and the amount so determined is the arm’s-length amount, unless:

(e) The CIR can demonstrate another amount to be a more reliable measure of the arm’s-length amount; or
(f) The taxpayer has not cooperated with the CIR in the CIR’s administration of this section in relation to that taxpayer and the non-cooperation has materially affected the CIR in that administration.

In either of these events the CIR determines the amount [s GC 13].

(4) Compensating arrangement: person paying less than arm’s-length amount
For the purposes of calculating a taxpayer’s income tax liability, the amount paid by them in a compensating acquisition arrangement is treated as an amount equal to the arm’s-length amount for the corresponding tax year when:

(a) The taxpayer is a party to a transfer pricing arrangement;
(b) An adjustment is made for an income year under s GC 7 or s GC 8;
(c) An amount of consideration payable by the taxpayer in the same income year, or in the previous or following income year, for an acquisition (the “compensating acquisition arrangement”) from the same person is less than an arm’s-length amount; and
(d) Either:
   (i) The transfer pricing arrangement involves goods, services, money, other intangible property, or anything else of the same type as that acquired in the compensating acquisition arrangement; or
   (ii) The amount of consideration actually payable or receivable in the transfer pricing arrangement is set having regard to the amount of consideration payable under the compensating acquisition arrangement [s GC 9].
Non-residents and Absentees

(5) **Compensating arrangement: person paying more than arm’s-length amount**
In the circumstances set out below, the amount received by a taxpayer in a compensating supply arrangement is treated as being an amount equal to the arm’s-length amount determined under s GC 13 for each of the following purposes:

(a) The calculation of their income tax liability for a tax year; and
(b) The determination of the obligation of another person to withhold tax from the amount under Part R.

The circumstances referred to above are when:

(a) The taxpayer is a party to a transfer pricing arrangement;
(b) An adjustment is made for a tax year under s GC 7 or s GC 8;
(c) An amount of consideration payable by the taxpayer in the same tax year, or in the previous or following tax year, for a supply (the “compensating supply arrangement”) to the same person is more than an arm’s-length amount; and
(d) Either:
   (i) The transfer pricing arrangement involves goods, services, money, other intangible property, or anything else of the same type as that acquired in the compensating supply arrangement; or
   (ii) The amount of consideration actually payable or receivable in the transfer pricing arrangement is set having regard to the amount of consideration receivable under the compensating supply arrangement [s GC 10].

(6) **Request for matching treatment**
When an arm’s-length amount is substituted under s GC 7 or s GC 8 for one party to a transfer pricing arrangement, the substitution applies also to the other party to the arrangement when:

(a) The other party to the arrangement (or, in the case of a CFC, a person with an income interest in the CFC) applies to the CIR within six months after an assessment is made for the first party reflecting the substitution;
(b) The CIR considers it is fair and reasonable to do so, having regard to an adjustment made under a double tax agreement or any other matter; and
(c) The CIR has notified the other party.

The substitution applies to the other party:

(a) Excluding the determination of the extent to which the other party has derived or been paid a dividend; and
(b) Including, when the other party is a CFC, the calculation of net attributable CFC income or net attributable CFC loss, and the resultant calculation of the attributed CFC income or an attributed CFC loss or attributed CFC net loss of a person [s GC 11].

**Transfer pricing guidelines**
Inland Revenue issued guidelines on the application of the transfer pricing rules in an appendix to TIB vol 12:10 (October 2000). The introduction to the guidelines notes that the guidelines are not issued as a binding public ruling — they are intended as a practical guide rather than as prescriptive rules. Further, Inland Revenue fully endorses the positions set out in the **OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations**, ch 1-8, and proposes to follow those positions in administering New Zealand’s transfer pricing rules. The guidelines should be read as supplementing the OECD guidelines, not as superseding them.
The overall objective of the transfer pricing guidelines is to make taxpayers aware of the steps they need to take to demonstrate that they have complied with the arm’s-length principle in ss GC 6 to GC 14. A detailed commentary on the guidelines is beyond the scope of this publication.

The guidelines deal with the following aspects:

(a) The rationale behind New Zealand’s adoption of the arm’s-length principle;
(b) The conceptual framework on which application of the acceptable transfer pricing methods is based;
(c) The general principles of comparability which form the foundations of transfer pricing analysis;
(d) The factors taxpayers should consider in determining the extent to which documentation should be prepared and maintained in support of their determination of arm’s-length price;
(e) The treatment of intangible property;
(f) The treatment of intra-group services, such as management fees;
(g) Cost contribution arrangements.

The guidelines apply only to the application of ss GC 6 to GC 14 — they therefore apply only to transactions between separate entities. They do not apply to transactions within a single entity such as between a parent company and its branch. Such transactions are subject instead to the apportionment rules in s YD 5 [see 1000.65].

The guidelines emphasise the importance of proper documentation. One of the key messages is that if taxpayers make a conscientious effort to establish transfer prices that comply with the arm’s-length principle, and prepare documentation as evidence of that compliance, Inland Revenue is likely to determine prima facie that those taxpayers represent a low tax risk, whereas taxpayers who give inadequate consideration to their transfer pricing practices are likely to receive closer attention.

1000.80 Non-resident’s assessment

The following example illustrates the imposition of income tax on a non-resident.

Example:

A married man, a resident of Australia, derives income from New Zealand from rent ($3,000), interest on debentures ($240), and dividends from New Zealand companies ($210), and he spends 20 weeks in New Zealand working for a New Zealand employer at a salary of $700 a week. His tax liability, based on 2011-2012 tax rates, is as follows:

Salary $700 a week for 20 weeks (PAYE deductions $2,073) $14,000
Rent $3,000
Taxable income $17,000
Income tax on $17,000 $1,995
Credit for tax deductions $2,073
Tax refund due $78

The period of 20 weeks’ presence in New Zealand is insufficient to make him a resident. Non-resident withholding tax (NRWT) will have been deducted from the dividends at the rate of 15 per cent since there is a DTA with Australia [see 310.45]. This is the final tax liability on this income. Dividends are not included in a non-resident’s assessment. NRWT at the rate of 10 per cent is also the final liability on the interest, unless the taxpayer is associated with the New Zealand payer. Any imputation credits attached to the dividends are not refunded to the non-resident taxpayer. However, the benefit of them may be passed on by the company to the non-resident as supplementary dividends [see 1010.20].

As an absentee, the taxpayer is also entitled to claim a proportionate amount of certain tax credits for the period he was working in New Zealand [see 1000.35].

1000.85 Thin capitalisation rules [ss FE 1, FE 2, FE 38, FE 39, FE 40, FE 41]

Editorial Note

At the time of publication of the Staples Tax Guide 2012, 72nd edition, the Taxation (International Investment and Remedial Matters) Bill had not been passed into law. It is anticipated that the content of this paragraph will be changed following the
passing of the Bill. For an overview of the changes contained in the Bill, please refer to the “Future Developments” section of
this book.
When enacted, these changes will also be available in the Staples Tax Guide online at www.brookersonline.co.nz. The changes
will also be included in the Staples Tax Guide 2012 - Mid-Year Supplement.

The thin capitalisation rules apportion certain interest expenditure between income that has a source in New
Zealand and other income for a New Zealand taxpayer who:
(a) Is controlled by a single non-resident, or is a New Zealand resident (an outbound entity) with an
income interest in a CFC, or a New Zealand resident that controls an outbound entity; and
(b) Has a disproportionately high level of debt funding in relation to their worldwide interest expenditure.
These rules also prescribe an acceptable level of equity for a foreign-owned bank, for the purposes of the
interest apportionment rules [s FE 1].
This anti-avoidance measure ensures that income derived in New Zealand is not shifted offshore by the
charging of excessively high interest costs to New Zealand based operations of a multinational company.
The interest apportionment rules may apply to the following persons if, at a time in an income year, they are:
(a) A non-resident who is not a company;
(b) A non-resident company, unless
   (i) A New Zealand resident has a direct ownership interest of 50 per cent or more in the company;
   and
   (ii) No non-resident has a direct ownership interest (including those of all associated persons) of
        50 per cent or more in the company;
(c) A company that is resident in New Zealand, if a non-resident has an ownership interest in the company
    of 50 per cent or more or has control of the company by any other means;
(d) The trustee of a non-complying trust settled by a non-resident, if the value of the settlements made
    by them (including the value of all settlements made by associated persons) are 50 per cent or more
    of the value of the settlements made on the trust;
(e) A company that is resident in New Zealand and has an income interest in a CFC;
(f) A company that is resident in New Zealand and has:
   (i) An ownership interest in a company described in (e) of 50 per cent or more;
   (ii) Control of a company described in (e) by any other means; or
(g) A natural person, or a trustee of a trust settled by a New Zealand resident, if the natural person or
    trustee is resident in New Zealand and has:
   (i) An income interest in a CFC;
   (ii) An ownership interest in a company described in (e) or (f) of 50 per cent or more;
   (iii) Control of a company described in (e) or (f) by any other means.
For the above purposes, a company is treated as being non-resident if it is treated under a double tax agreement
as not being resident in New Zealand [s FE 2].

1 Ownership interests [ss FE 38, FE 39, FE 40, FE 41]
A person’s ownership interest in a company is the total of the following percentages:
(a) Any direct ownership interests they hold in the company;
(b) Any direct ownership interests held in the company by an associated person;
(c) Any indirect ownership interests they hold in the company; and
(d) Any indirect ownership interests held in the company by an associated person.
A person’s direct ownership interest in a company is equal to the highest percentage of shares or rights the
person holds in the categories listed in s EX 5(1) [see 850.25]. A person’s direct ownership interests include
the direct ownership interests of a person associated with them. However, the same percentage shares or rights in a company may not be counted more than once.

An indirect ownership interest arises when a person has a direct ownership interest in a company (company A), which has an ownership interest in another company (company B). If the person’s direct ownership interest in company A is less than 50 per cent, they are treated as holding an indirect ownership interest in company B equal to their direct ownership interest in company A multiplied by company A’s ownership interest in company B. If the person’s direct ownership interest in company A is equal to or more than 50 per cent, they are treated as holding an indirect ownership interest in company B equal to company A’s ownership interest in company B.

A non-resident who does not have a direct or indirect ownership interest in a company and a relative resident in New Zealand are not associated persons in relation to the company.

1000.90 Apportionment of interest expenditure [ss CH 9, CH 10, FE 5, FE 6, FE 7]

(1) Threshold for excess debt entity [s FE 5(1)]

An excess debt entity must apportion its interest expenditure for an income year if:

(a) The excess debt entity is not a trustee and not an excess debt outbound company, or is a trustee who is not described in s FE 2(1)(g) [see 1000.85], and:
   (i) The debt percentage of its New Zealand group for the income year is more than 60 per cent; and
   (ii) For a company or a trustee, the debt percentage of its New Zealand group for the income year is more than 110 per cent of the debt percentage of the worldwide group; or

(b) The excess debt entity is an excess debt outbound company, or is a trustee who is described in s FE 2(1)(g), and:
   (i) The debt percentage of its New Zealand group for the income year is more than 75 per cent; and
   (ii) For a company or a trustee, the debt percentage of its New Zealand group for the income year is more than 110 per cent of the debt percentage of the worldwide group.

An “excess debt entity” for an income year is a person who:

(a) Meets the requirements of s FE 2 in the income year [see 1000.85];
(b) Is not, at any time in the income year, a reporting bank for a New Zealand banking group, or a part of a New Zealand banking group; and
(c) Is not a natural person (unless acting as a trustee) [s FE 4].

(2) Exception for excess debt outbound companies [s FE 5(1B), (1C)]

An excess debt outbound company and a natural person or trustee who is described in s FE 2(1)(g) do not have to apportion interest expenditure for an income year if, for the income year:

(a) The ratio of the total group assets measured under s FE 16 for its New Zealand group to the total group assets measured under s FE 18 for its worldwide group is 90 per cent or greater; or

(b) Its New Zealand group:
   (i) Has a total amount of deductions for interest allowed under ss DB 6 to DB 8 to the group, less the total deductions allowed in relation to interest payable intra-group, that is not greater than $250,000; and
   (ii) Does not include an entity with an income interest in a CFC, and the CFC derives rent from land in the country or territory in which the CFC is resident.

For these purposes, the total group assets of a natural person’s worldwide group under s FE 18 are measured on the basis that the natural person is an excess debt entity that has a worldwide group made up of:
(a) The natural person;
(b) The natural person’s New Zealand group; and
(c) All CFCs in which the natural person or a member of the natural person’s New Zealand group has an income interest.

3 Threshold for reporting bank [s FE 5(2)]

A reporting bank must apportion its interest expenditure for an income year if:

(a) The New Zealand net equity of its New Zealand banking group for a tax year is less than its equity threshold; and
(b) Its group funding debt for the corresponding tax year is positive.

A “reporting bank” for an income year for a New Zealand banking group is a person who:

(a) Meets the requirements of s FE 2 in the income year; and
(b) Is the registered bank in the banking group — subject to s FE 36 [see 1000.135]

4 Threshold for natural person [s FE 5(3)]

A natural person must apportion their interest expenditure for an income year if:

(a) They are not described in s FE 2(1)(g) and the debt percentage of their New Zealand group for the income year is more than 60 per cent; or
(b) They are described in s FE 2(1)(g) and the debt percentage of their New Zealand group for the income year is more than 75 per cent.

5 Apportionment of interest by excess debt entity [s FE 6(1) to (3)]

A natural person or an excess debt entity required to apportion their interest under s FE 5 is treated as deriving, under s CH 9, an amount of income calculated for the income year as follows:

\[
\text{Total deduction} + \text{FRD} - \text{adjust} \times (\text{total debt} - \text{concession} / \text{total debt}) \times (\text{group debt percentage} - \text{threshold amount} / \text{group debt percentage})
\]

Where:

“Total deduction” is the whole amount of the excess debt entity’s deduction for interest allowed under ss DB 6 to DB 8, less:

(a) The total amount allowed in relation to interest payable to a company that is a member of the entity’s New Zealand group under ss FE 3 and FE 28 (not including an amount referred to in (b)); and
(b) The total amount allowed in relation to interest payable under a financial arrangement excluded from the total group debt of its New Zealand group under s FE 15.

“FRD” is the total amount of dividends paid by the excess debt entity in relation to fixed-rate foreign equity of fixed-rate shares issued by the entity and held by a person resident in New Zealand who is not a company that is a member of the entity’s New Zealand group.

“Adjust” is:

(a) Zero, if the excess debt entity is not an excess debt outbound company or a natural person or trustee described in s FE 2(1)(g);
(b) The amount (the group finance cost) that is the total amount for the New Zealand group found by calculating for each member of the New Zealand group the total amount (the member finance cost) of the items total deduction and FRD for the member, if the group finance cost is $1,000,000 or less and (a) does not apply;
(c) The amount found by multiplying the amount by which $2,000,000 exceeds the group finance cost by the ratio obtained by dividing the member finance cost for the excess debt entity by the group finance cost, if the group finance cost is more than $1,000,000 and less than $2,000,000 and (a) does not apply; or
(d) Zero, if the group finance cost is $2,000,000 or more and (a) does not apply.

“Total debt” is the total amount of debt of the excess debt entity’s New Zealand group for the income year calculated under s FE 15, before allowing for a reduction under s FE 13 [see 1000.110].

“Concession” is any reduction allowed under s FE 13 in the total group debt of the excess debt entity’s New Zealand group for the income year, averaged when s FE 8(1)(a) or (b) applies.

“Group debt percentage” is the debt percentage of the excess debt entity’s New Zealand group for the income year.

“Threshold amount” is:

(a) If the excess debt entity is not a trustee and not an excess debt outbound company, or is a trustee who is not described in s FE 2(1)(g), the greater of 60 per cent and 110 per cent of the debt percentage of their worldwide group;

(b) If the person is a natural person who is not described in s FE 2(1)(g), 60 per cent;

(c) If the excess debt entity is an excess debt outbound company, or is a trustee who is described in s FE 2(1)(g), the greater of 75 per cent and 110 per cent of the debt percentage of their worldwide group; or

(d) If the person is a natural person who is described in s FE 2(1)(g), 75 per cent.

(6) Alternative calculation [s FE 6(4), (5)]

If a company that is in the same wholly-owned group of companies as the excess debt entity has a deduction for interest under any of ss DB 6 to DB 8, the company may choose to be treated as deriving the income that the excess debt entity would otherwise be treated as deriving for the income year. The amount of income is not calculated using the formula set out above. The amount of income for which the company may make the above election must not be more than the total amount of deductions that the company has for interest for the income year, having taken into account any other income that the company chooses to treat itself as deriving under s FE 6(4).

(7) Apportionment of interest by reporting bank [s FE 7]

A reporting bank that is required to apportion its interest under s FE 5(2) is treated as deriving an amount of income under s CH 10 calculated using the formula:

\[\text{amount below threshold} \times \left( \frac{\text{interest expenditure}}{\text{group funding debt}} \right) \times \left( \frac{\text{days in period}}{\text{days in year}} \right)\]

Where:

“Amount below threshold” is the amount by which the New Zealand net equity for the New Zealand banking group is less than the equity threshold under s FE 19.

“Interest expenditure” is the financial value for the New Zealand banking group of interest expenditure measured under generally accepted accounting practice that is incurred:

(a) By a member of the New Zealand banking group in the income year; and

(b) Other than in relation to a share that contributes to the item “total interest” in the formula in s FE 23, or is a deduction referred to in the definition of the item “interest deductions” in that section.

“Days in period” is the number of days in the relevant measurement period.

“Group funding debt” is the group funding debt for the New Zealand banking group for the corresponding tax year.

“Days in year” is the number of days in the income year.

1000.95 Measurement period [s FE 8]

When measuring the amount of total group debt and total group assets of its New Zealand group for the income year, an excess debt entity must elect the basis on which it is to be measured:

(a) The average amount at the end of each day of the income year;
The average amount at the end of each three-month period in the income year; or
(c) The amount at the end of the income year.

For these purposes, the income year is determined by the balance date of the New Zealand parent.

A reporting bank [see 1000.135] must measure both the equity threshold and the net equity of its New Zealand banking group for an income year on one of the following dates:
(a) On each day of the income year;
(b) On the last day of each calendar month of the income year; or
(c) If the reporting bank does not choose (a) or (b), on the last day of each quarter of an income year.

If the identity of the reporting bank changes, the first measurement date for the new reporting bank is the day after the last measurement date of the former reporting bank.

**1000.100 Elections** [s FE 9]

For the purposes of the thin capitalisation rules, an election or choice is made by providing a return of income for the relevant income year. A choice of measurement date [see 1000.95] may be changed after a notice of assessment for an income year is received from the CIR. A choice of control threshold, or an election to include certain other companies in a New Zealand group [see 1000.115] by a person other than an excess debt entity is made by providing notice to the CIR with the return of income for the relevant income year.

**1000.105 Currency** [s FE 10]

The following values must be calculated in New Zealand currency for the thin capitalisation rules:
(a) Total group debt and total group assets of a New Zealand group or a worldwide group; and
(b) A financial arrangement or risk-weighted exposure.

An excess debt entity must convert foreign currency to New Zealand currency at:
(a) The close of trading spot exchange rate for the foreign currency on the relevant measurement date [see 1000.95]; or
(b) The forward exchange rate that applies on the first day of the income year for the relevant measurement date.

A reporting bank must convert foreign currency to New Zealand currency at the close of trading spot exchange rate for the foreign currency on the relevant measurement date.

**1000.110 Rules for calculating debt percentage of a group** [ss FE 12, FE 14, FE 15, FE 16.]

The debt percentage of a group is the percentage of total group debt to total group assets for the income year or accounting year [s FE 12].

**Example:**

If total group debt is $900,000 and total group assets equal $1,000,000, then the debt percentage of the group is 90 per cent.

The New Zealand group, for an excess debt entity is a company, is made up of all companies, traced tier by tier, that are identified as within the control threshold of the New Zealand parent [s FE 27].

The worldwide group, for an excess debt entity is a company, is made up of all companies, traced tier by tier, that are included in both the entity’s New Zealand group and the ultimate non-resident parent’s worldwide group [s FE 31].

If the excess group entity is a trustee, the memberships of the New Zealand group and the worldwide group are determined as follows:

(a) The trustee’s New Zealand group is made up of the trustee and all associated persons who are resident in New Zealand, or carrying on business in New Zealand through a fixed establishment in New Zealand; or
(b) The debt percentage is calculated by determining the total group debt and total group assets of the members of the New Zealand group on a consolidated basis equivalent to the generally accepted accounting practice for the consolidation of a group of companies for the purposes of eliminating intra-group balances [s FE 3(2)].

(1) **Consolidation of debts and assets [s FE 14]**

If the excess debt entity is a company, the debt percentage of a New Zealand group is calculated under generally accepted accounting practice for the consolidation of companies for the purposes of eliminating intra-group balances, by consolidating the debts and assets of the members of the entity’s New Zealand group.

For a natural person and an excess debt entity that is a trustee, the debt percentage of a New Zealand group is calculated under generally accepted accounting practice for the consolidation of companies for the purposes of eliminating intra-group balances by consolidating the debts and assets of the group.

If a member of a New Zealand group is not resident in New Zealand, the assets and debts of the member are included in a consolidation only to the extent to which the assets and debts are for the group member to:

(a) Carry on business in New Zealand through a fixed establishment in New Zealand;
(b) Derive income that has a source in New Zealand and for which relief from New Zealand tax under a double tax agreement is unavailable.

For the purposes of determining total group debt and total group assets, and for calculating an amount for which a deduction is denied:

(a) Specified leases are treated as financial arrangements that provide funds to the issuer;
(b) Expenditure incurred by the lessee under a specified lease for which a deduction is allowed under s BD 2 is treated as an amount of interest to which any of ss DB 6 to DB 8 applies; and
(c) Interest that is allowed as a deduction under s DP 1(1)(b) (expenditure of forestry business) or s DV 10(1)(a) or (b) (building societies) is treated as an amount of interest to which any of ss DB 6 to DB 8 applies, if not already allowed under these sections [s FE 14].

(2) **Total group debts and assets [ss FE 15, FE 16]**

“Total group debt” means the sum of the outstanding balances of:

(a) Financial arrangements entered into by a natural person, or an excess debt entity, or another member of the New Zealand group, if the financial arrangement:
   (i) Provides funds to the natural person, the entity or another member of the group; and
   (ii) Gives rise to an amount for which the natural person, the entity or another member of the group would have a deduction (not including an amount that arises only from movement in currency exchange rates);
(b) Fixed-rate foreign equity or fixed-rate shares that are issued by the entity or another member of the New Zealand group and held by a person resident in New Zealand;
(c) Staples debt securities that are issued by the entity or another member of the New Zealand group, held by a person resident in New Zealand and stapled to shares other than shares of a company that is a proportional-stapling company [s FE 15].

A “proportional-stapling company” means a company if:

(a) Each share in the company that is not a stapled debt security and not a fixed-rate share (a participating share) is stapled to a stapled debt security; and
(b) For each participating share in the company, the amount payable for the issue of its stapled debt security is the same proportion of the available subscribed capital calculated under the slice rule of the participating share as it is for each other participating share.
“Total group assets” for an income year means the total assets for a natural person, an excess debt entity or another member of the New Zealand group, measured under the applicable one or more of the following methods, as chosen by the person or entity:

(a) The value of the assets shown in the financial statements of the entity’s New Zealand group;
(b) The net current value of the assets;
(c) Market value, for trading stock that is valued at market value in calculating the person or entity’s income tax liability for the income year, or that of a member of the group;
(d) Adjusted tax value of a personal property lease asset at the start of the income year, in the case of a specified lease or a finance lease that is not recognised as an asset under generally accepted accounting practice; or
(e) If allowed under generally accepted accounting practice, a combination of the financial statement values and net current values.

If the excess debt entity or another member of the New Zealand group has an investment in a CFC in which the entity or member has an income interest, the value of the total group assets calculated and measured under s FE 16 does not include the value of the investment, except:

(a) To the extent to which–
   (i) The value of the investment represents the outstanding balances of financial arrangements to which s FE 13 applies:
   (ii) The CFC derives income with a source in New Zealand and for which relief from New Zealand tax under a double tax agreement is unavailable;
(b) That the value of the total group assets is treated as being $1 if the value would otherwise be zero as a result of this subsection.

If the excess debt entity or another member of a New Zealand group is not resident in New Zealand, the assets of the entity or member are included in the calculation and measurement of total group assets under this section only to the extent to which the assets are for the entity or member to:

(a) Carry on business in New Zealand through a fixed establishment in New Zealand;
(b) Derive income that has a source in New Zealand and for which relief from New Zealand tax under a double tax agreement is unavailable.

The amount of total group assets must be calculated under generally accepted accounting practice, except for the values referred to in (c), (d) and (e) [s FE 16].

1000.115 Determining membership of New Zealand group [ss FE 25, FE 26, FE 27, FE 28, FE 29, FE 30]

(1) Process [s FE 25]

The membership of the New Zealand group of an excess debt entity that is a company is determined by:

(a) Identifying the New Zealand parent;
(b) Establishing the companies under the parent’s control;
(c) Identifying the members of the New Zealand group; and
(d) If a non-resident has ownership interests in two or more New Zealand groups, establishing whether the groups may be combined into a single New Zealand group.

Section FE 30 (as explained below) does not apply to an excess debt outbound company.

(2) New Zealand parent [s FE 26]

The excess debt entity is treated as the New Zealand parent if it is not resident in New Zealand. An excess debt entity that is resident in New Zealand is treated as the New Zealand parent if:

(a) A non-resident has a direct ownership interest in the entity of 50 per cent or more; and
(b) No single non-resident carrying on a business in New Zealand through a fixed establishment in New Zealand, or who derives income that has a source in New Zealand and for which relief from New Zealand tax under a double tax agreement is unavailable, has an ownership interest in the entity of 50 per cent or more.

An excess debt entity is treated as the New Zealand parent if the entity is an excess debt outbound company and no single company resident in New Zealand has an ownership interest in the entity of 50 per cent or more.

If the excess debt entity is not the New Zealand parent, and the excess debt entity is not an excess debt outbound company, the entity’s New Zealand parent is the company (company A) that meets all the following requirements:

(a) Company A is either:
   (i) Resident in New Zealand;
   (ii) Not resident but carrying on business in New Zealand through a fixed establishment in New Zealand; or
   (iii) Not resident in New Zealand but deriving income that has a source in New Zealand and for which relief from New Zealand tax under a double tax agreement is unavailable;

(b) Company A has an ownership interest in the entity;

(c) A non-resident has a direct ownership interest in company A;

(d) If company A is resident in New Zealand, a non-resident who has an ownership interest in the entity of 50 per cent or more also has an ownership interest in the company of 50 per cent or more; and

(e) No other company that meets the requirements of (a) to (d) has a direct ownership interest in company A.

If the interest apportionment rule [see 1000.90] applies to the excess debt entity only because the entity is a resident company that a non-resident controls by “any other means” [s FE 2(1)(c)(ii)], the entity’s New Zealand parent is the company (company B) that meets all the following requirements:

(a) Company B is either:
   (i) Resident in New Zealand, or
   (ii) Not resident but carrying on business in New Zealand through a fixed establishment in New Zealand; or
   (iii) Not resident in New Zealand but deriving income that has a source in New Zealand and for which relief from New Zealand tax under a double tax agreement is unavailable;

(b) Company B has an ownership interest in the entity;

(c) If company B is resident in New Zealand, a non-resident who has control of the entity by any means has control of company B by any means; and

(d) No other company that meets the requirements of (a) to (c) has a direct ownership interest in company B.

Ownership interests are determined under ss FE 38 to FE 41 [see 1000.85], but for the purpose of identifying a New Zealand parent the ownership interests of an associated person are ignored.

If more than one company is identified as New Zealand parent, the New Zealand parent is the company that has the highest value in ownership interests calculated by multiplying:

(a) The total direct ownership interests in company A or company B of non-residents who also have ownership interests in the entity of 50 per cent or more; or

(b) The ownership interests of either company in the entity.

The excess debt entity is treated as the New Zealand parent if none of the above tests identifies a parent.
(3) **Companies under parent’s control [s FE 27]**

The New Zealand parent may choose, as the relevant control threshold, a percentage that is either:

(a) More than 50 per cent; or
(b) 66 per cent or more.

The chosen percentage must be applied consistently to all companies that are members of the group. If a control threshold is not chosen, the default control threshold is 66 per cent or more. The control threshold applying for an income year in relation to the entity and its New Zealand parent applies to any company of the New Zealand parent.

If the New Zealand parent elects a control threshold of more than 50 per cent, the company or companies treated as controlled by the New Zealand parent are those in which direct ownership interests of more than 50 per cent are held collectively by either or both:

(a) The New Zealand parent; and
(b) Any other company included in the New Zealand group.

If the New Zealand parent elects a control threshold of 66 per cent or more, the companies treated as controlled by the New Zealand parent are those in which direct ownership interests of 66 per cent or more are held collectively by any combination of:

(a) The New Zealand parent;
(b) A non-resident if:
   (i) They have ownership interests of 50 per cent or more in both the entity and the New Zealand parent; and
   (ii) A company included in the New Zealand group as a result of the control percentage would have been included in the group under s FE 28 through the application of the “over 50 per cent” control test had that control percentage been chosen; and
(c) Any other company or companies that are included in the New Zealand group under s FE 28.

(4) **Members of New Zealand group [ss FE 28, FE 29]**

A New Zealand group consists of:

(a) An excess debt entity;
(b) The entity’s New Zealand parent;
(c) A company that is:
   (i) Resident in New Zealand or carrying on a business in New Zealand through a fixed establishment in New Zealand;
   (ii) Under the control of the New Zealand parent;
   (iii) Not a member of the New Zealand banking group of a registered bank;
(d) A CTR holding company [defined in s YD 10].

If the excess debt entity is not a company under the control of a New Zealand parent (because the threshold is not met), the New Zealand group is made up of:

(a) The entity;
(b) Any company that is resident in New Zealand or carrying on a business in New Zealand through a fixed establishment in New Zealand, and that:
   (i) Would be under control of the entity if the entity was treated as the New Zealand parent;
   (ii) Would be under the control of another company (company A) if the entity is identified as under the control of company A, and company A is included in the New Zealand group and treated as the New Zealand parent;
Non-residents and Absentees

(iii) Would be under the control of company A if company A was treated as the New Zealand parent; or
(iv) Is not a member of the New Zealand banking group of a registered bank; and

(c) A CTR holding company [s FE 28].

A company is included in an excess debt entity’s New Zealand group if it is:

(a) On the measurement date [see 1000.95], a CTR holding company for a CTR company:
   (i) That is a member of the entity’s New Zealand group; and
   (ii) In which the holding company has direct ownership interests of more than 50 per cent; or

(b) A member of the New Zealand group of a company described in (a).

Two New Zealand groups (group 1 and group 2) are combined into a single New Zealand group when a natural person or trustee described in s FE 2(1)(g) has:

(a) A 50 per cent or more ownership interest in a member of a New Zealand group (group 1) having a member that is an excess debt outbound company; and

(b) A 50 per cent or more ownership interest in a member of a different New Zealand group (group 2) having a member that is an excess debt outbound company [s FE 29].

(5) Ownership interests in two or more New Zealand groups [s FE 30]

Special rules apply when:

(a) A New Zealand group is in existence;

(b) A particular excess debt entity (company A), that is not an excess debt outbound company, is outside the group;

(c) Company A is:
   (i) Resident in New Zealand, or
   (ii) Carrying on business in New Zealand through a fixed establishment in New Zealand; or
   (iii) Deriving income that has a source in New Zealand and for which relief from New Zealand tax under a double tax agreement is unavailable;

(d) A single non-resident has ownership interests of 50 per cent or more in both:
   (i) The New Zealand group; and
   (ii) Company A.

If the above conditions are met, the New Zealand parent of company A may choose to include the company in the New Zealand group if every company to be included in the enlarged group that is a New Zealand parent in the group makes the same election in relation to all other companies that are not in a New Zealand group with that parent.

However, company A cannot be part of the New Zealand group if:

(a) Another company (company B) that is outside the group has a direct ownership interest in company A;

(b) Company B is:
   (i) Resident in New Zealand, or
   (ii) Carrying on business in New Zealand through a fixed establishment in New Zealand; or
   (iii) Deriving income that has a source in New Zealand and for which relief from New Zealand tax under a double tax agreement is unavailable; and

(c) Either:
   (i) A New Zealand parent in the group, after the application of the previous rule, has control of company B under s FE 27(3) (relating to a control threshold of more than 50 per cent); or
   (ii) The single non-resident has ownership interest of 50 per cent or more in company B.
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1000.120 Rules for calculating debt percentage of worldwide group
[ss FE 12, FE 17, FE 18]

(1) Calculation of debt percentages [s FE 12]

If the debt percentage of a New Zealand group is more than the appropriate percentage specified in s FE 5(1) [see 1000.90], then the entity must calculate the debt percentage of their worldwide group. A debt percentage of a group is found by dividing the amount of the total group debt by the amount of total group assets for an income year or accounting year, as applicable.

If the excess debt entity is a company, the worldwide group is made up of all companies included as members of the worldwide group under:
(a) Sections FE 31 and FE 32, for an excess debt entity that is not an excess debt outbound company;
(b) Sections FE 31B to FE 32, for an excess debt outbound company.

(2) Consolidation of debts and assets [s FE 17]

For an excess debt entity that is a company, the debt percentage of a worldwide group is calculated under generally accepted accounting practice for the consolidation of companies for the purposes of eliminating intra-group balances by consolidating the debts and assets of the members of the entity’s worldwide group using:
(a) A financial standard used in the country in which the entity’s ultimate non-resident parent resides, if applicable; or
(b) Generally accepted accounting practice.

(3) Measurement of debts and assets of worldwide group [s FE 18]

The amount of total group debt and the amount of total group assets of the worldwide group of an excess debt entity must be calculated:
(a) Using a standard that is equivalent to generally accepted accounting practice for consistent and non-distorting financial reporting; and
(b) In accordance with the financial reporting standards of the country where the worldwide group’s consolidated financial accounts are prepared.

For this purpose, an excess debt entity must measure the amount of total group debt by applying s FE 15 [see 1000.110] as if it referred to a deduction that would be allowed if the entity, or another group member, were resident in New Zealand.

The amount of total group debt and the amount of total group assets of the worldwide group of an excess debt entity for an income year are measured using:
(a) The average amount at the end of each day of the income year;
(b) The average amount at the end of each three-month period in the income year; or
(c) The amount as at the worldwide group’s balance date that immediately precedes the income year.

If an excess debt entity is unable to calculate the debt percentage of their worldwide group for an income year, they may ask the CIR to estimate the percentage.

(4) Default percentages [s FE 18(5)]

A default percentage may be used as the debt percentage of the worldwide group of an excess debt entity if:
(a) The entity is unable to calculate the percentage, and does not ask the CIR to estimate the percentage;
(b) The CIR cannot reasonably estimate the debt percentage; or
(c) Every member of the entity’s worldwide group, except the entity, is resident in New Zealand.

The default percentages are as follows:
Non-residents and Absentees 1000.125

The excess debt entity is not a trustee and not an excess debt outbound company, or is a trustee who is not described in s FE 2(1)(g).
The excess debt entity is an excess debt outbound company, or is a trustee who is described in s FE 2(1)(g).

54.5454%

68.1818%

1000.125 Determining membership of worldwide group [ss FE 31, FE 32]

A worldwide group for an income year, for an excess debt entity that is a company but not an excess debt outbound company, is made up of:

(a) The entity;

(b) The entity’s New Zealand group for the income year;

(c) The entity’s worldwide GAAP group (see below);

(d) The entity’s ultimate non-resident parent (see below);

(e) The ultimate non-resident parent’s worldwide GAAP group (see below);

(f) Any non-resident that:

(i) Is not a company; and

(ii) Has ownership interests in the entity of 50 per cent or more; and

(g) Any person associated with the non-resident referred to in (f).

An excess debt entity’s worldwide GAAP group is made up of all non-residents who are required to be included with the entity in the consolidated financial statements under, as the entity chooses:

(a) Generally accepted accounting practice (GAAP); or

(b) An equivalent standard for consistent and non-distorting financial reporting that is:

(i) Set in the country where the ultimate non-resident parent of the parent resides; or

(ii) Applied when preparing the consolidated financial statements of the international group of which the entity is part.

An excess debt entity’s ultimate non-resident parent is the company that meets the following requirements:

(a) The company has ownership interests in the entity of 50 per cent or more;

(b) The company is not excluded from the entity’s worldwide group under s FE 32; and

(c) No other company has both:

(i) An ownership interest in the entity of 50 per cent or more; and

(ii) An ownership interest in the company referred to in (a) and (b).

For these purposes, ownership interests are determined under ss FE 38 to FE 41 [see 1000.60].

The ultimate non-resident parent’s worldwide GAAP group is made up of:

(a) The ultimate non-resident parent; and

(b) Any non-resident who is required to be included with the ultimate non-resident parent in consolidated group accounts under, as the non-resident parent chooses:

(i) The standard set in the country where the ultimate non-resident parent of the parent resides, if applicable; or

(ii) Generally accepted accounting practice (GAAP) [s FE 31].

A joint venture company may choose to exclude a joint venture (referred to as the “excluded joint venturer”) from its worldwide group for an income year if:
(a) A person (the excluded joint venturer) holds an ownership interest equal to 50 per cent in the joint venture company;
(b) One other person (the included joint venturer) in the worldwide group holds an ownership interest equal to 50 per cent in the joint venture company; and
(c) But for the application of s FE 32, the worldwide group includes every person who holds both an ownership interest equal to 50 per cent in the joint venture company and
   (i) Who has an ownership interest in the included joint venturer; or
   (ii) In whom the included joint venture company has an ownership interest.
Ownership interests are determined under ss FE 38 to FE 41 [s FE 32; see 1000.85].

1000.130 Adjustment when lending outside group [s FE 13]
The provisions set out below apply when a natural person, a member of a natural person’s New Zealand group, an excess debt entity, or a member of an entity’s New Zealand group or worldwide group, enters into a financial arrangement with another person (person A), and the financial arrangement:
(a) Provides funds to person A; and
(b) Would otherwise be included in the calculation of the debt percentage of the natural person, excess debt entity, New Zealand group or worldwide group.

In the calculation of the debt percentage of the New Zealand group and a worldwide group, the amount of total group debt and total group assets is reduced by the outstanding balance of the financial arrangement.

In the calculation of the debt percentage of a New Zealand group, the reduction applies if the consideration for the financial arrangement is at arm’s length, and person A is one of the following:
(a) A non-resident who is not carrying on a business through a fixed establishment in New Zealand and who:
   (i) Does not derive income that has a source in New Zealand;
   (ii) Derives income that has a source in New Zealand and, for all of that income, relief from New Zealand tax under a double tax agreement is available;
(b) A person who is not associated with the excess debt entity; or
(c) A person who is associated with the excess debt entity but is:
   (i) Not a member of the New Zealand group; and
   (ii) A person to whom subpart FE may apply under s FE 2 [see 1000.85].

In the calculation of the debt percentage of a worldwide group, the reduction applies if person A is not associated with the excess debt entity.

1000.135 New Zealand banking group [ss FE 33, FE 34, FE 35, FE 36, FE 37]
The membership of a New Zealand banking group is determined by:
(a) Identifying the ultimate parent of a registered bank;
(b) Determining whether a person may be excluded from a banking group; and
(c) Identifying a person and a fixed establishment as a member of a banking group [s FE 33].
The ultimate parent is the company identified as follows:
(a) An ultimate parent of a registered bank is a company that has an ownership interest in the registered bank of 50 per cent or more, and in which no other company that has an ownership interest in the registered bank of 50 per cent or more has an ownership interest; or
(b) The ultimate parent of a registered bank’s fixed establishment in New Zealand is the registered bank [s FE 34].

A reporting bank may determine the members of its New Zealand banking group by excluding from the group a person or fixed establishment as follows:
(a) A person or a fixed establishment whose main activity is providing life insurance;

(b) A person resident in New Zealand who has a voting interest of 100 per cent in a person excluded under (a), and whose main activity is not banking, financing, or leasing, or the ownership or control of an entity whose main activity is banking, financing, or leasing;

(c) A person resident in New Zealand who is required under generally accepted accounting practice to be included in consolidated group accounts with a person or fixed establishment excluded under subsection (a) or (b), and whose main activity is not banking, financing, or leasing, or the ownership or control of an entity whose main activity is banking, financing, or leasing;

(d) A fixed establishment of a non-resident if:
   (i) The non-resident has a voting interest of 100 per cent in a person excluded under (a);
   (ii) The fixed establishment has a main activity of financing the person excluded under (a); and
   (iii) The main activity of the fixed establishment is not banking, financing, or leasing, or the ownership or control of an entity whose main activity is banking, financing, or leasing.

The New Zealand banking group of a registered bank includes the following entities:

(a) The registered bank, if resident in New Zealand;

(b) The registered bank’s fixed establishment, if the registered bank is not resident in New Zealand;

(c) A resident person included in the banking group if:
   (i) The person is part of the same group of companies as the registered bank;
   (ii) The following conditions under generally accepted accounting practice (GAAP) are met:
      (A) For a resident registered bank with no non-resident ultimate parent, the consolidated group accounts include both the person and the registered bank, or would include both but for relevant materiality thresholds; or
      (B) For a non-resident registered bank with no non-resident ultimate parent, the consolidated group accounts would include the person and the registered bank if the registered bank were resident in New Zealand and the relevant materiality thresholds were met;

(d) A resident is included in the banking group if:
   (i) The person is part of the same group of companies as a non-resident ultimate parent; and
   (ii) Under generally accepted accounting practice (GAAP), the consolidated group accounts would include the person and the ultimate parent if the ultimate parent were resident in New Zealand and the relevant materiality thresholds were met;

(e) A fixed establishment in New Zealand of a non-resident is included in the banking group separately from the non-resident if:
   (i) The fixed establishment is part of the same group of companies as a non-resident registered bank with no non-resident ultimate parent; and
   (ii) Under generally accepted accounting practice, the consolidated group accounts would include the fixed establishment and the registered bank if the registered bank were resident in New Zealand and the relevant materiality thresholds were met;

(f) A fixed establishment in New Zealand of a non-resident is included in the banking group separately from the non-resident if:
   (i) The fixed establishment is part of the same group of companies as a non-resident ultimate parent; and
   (ii) Under generally accepted accounting practice, the consolidated group accounts would include the fixed establishment and the ultimate parent if the ultimate parent were resident in New Zealand and the relevant materiality thresholds were met.
The reporting bank for the day is the registered bank on a day when a New Zealand banking group has either:
(a) A single registered bank; or
(b) No registered bank but a fixed establishment of a single registered bank.
However, if a New Zealand banking group has either more than one registered bank or no registered bank but fixed establishments of more than one registered bank, the reporting bank is:
(a) The registered bank that first notifies the CIR of an election to be the reporting bank, if the CIR receives the notice within six months after the end of the income year in which the day occurs; or
(b) If no notice is received, the registered bank chosen by the CIR [s FE 37].

1000.140 Determinations [TAA, s 90A]
The CIR may determine the extent to which a financial arrangement provides funds to a party under the arrangement, for the purposes of the interest apportionment rules under subpart FE. Any determination made is binding for the purposes of subpart FE. Any taxpayer may apply to the CIR to exercise a discretion to make a determination. The CIR may at any time make a determination that varies, cancels, restricts or extends in scope an earlier determination, or issue a notice that cancels a determination.
A person who enters into a financial arrangement before the date of notification or publication of a determination or notice is not required to apply the determination to the financial arrangement, or treat the notice as affecting the financial arrangement, until the first tax year that commences after the date of notification or publication. All such determinations and notices issued by the CIR shall be published in the Gazette within 30 days of their making (ie when it is signed by the CIR).
If a person has applied a determination made under s 90A(1) of the TAA, an assessment made in respect of the person must be in accordance with the determination, except where:
(a) Since the date of the determination, the legislation on which the determination was based has been repealed or amended to the detriment of the person relying on the determination; or
(b) There was a material misrepresentation or omission in the application for the determination, whether intentional or not.
Chapter 1010

Non-resident Investors

1010.10 Non-resident investor regime [s LP 1]

The non-resident investor regime is also commonly referred to as the “foreign investor tax credit” (FITC) regime. When a company pays an imputed dividend to a non-resident shareholder, that company is allowed a credit against its own income tax liability if it also pays a supplementary dividend to the non-resident. The amount of the credit allowed is the amount of the supplementary dividend paid. The effect of paying a supplementary dividend is that the benefit of the imputation credits allocated to the dividend is passed on to the non-resident shareholder, and the company receives a credit against its own income tax liability to compensate it for paying the supplementary dividend. If the dividend is fully imputed and paid to a shareholder in a country with which New Zealand has a double tax agreement, the amount of the supplementary dividend is sufficient to cover the total NRWT liability on the dividend [see 1010.20 and 215 CONDUIT TAX RELIEF].

1010.20 Supplementary dividend [ss LP 2, OZ 12]

The supplementary dividend is an additional dividend paid to the same shareholder for an earlier dividend. It must be paid in the same income year as the first dividend. The FITC regime enables non-resident shareholders, who would otherwise not benefit from imputation credits attached to dividends, to receive the benefit of the tax paid by the company. In effect, the reduced company tax allows a supplementary dividend to be paid and the company pays that amount as NRWT for the benefit of the non-resident shareholder. This is shown as an extra (ie supplementary) dividend which follows the first dividend. Only non-resident shareholders get the supplementary dividend. Resident shareholders do not.

(1) FITC calculation for 2008-2009 and subsequent income years

The company income tax rate changes as from the 2008-2009 tax year which impacts the amount of the credit under the FITC regime. Consequently, the credit is calculated by multiplying the amount of the allocated credit by 7/10 instead of 67/187.

Note: In a transitional period from the start of the 2008-2009 income year until 31 March 2010 a company may choose to attach imputation credits to dividends up to the higher imputation ratio of 33/67 [see 670.45].

The new credit is $0.70 for every dollar of FITC-adjusted imputation credits that are attached to dividends paid to non-resident investors.

Prior to 2008-2009, the FITC was calculated by multiplying the imputation credit by 0.358275. This changes from 2008-2009, by multiplying the imputation credits the New Zealand company would usually distribute to its non-resident investors by 0.411806. The amounts given in the above example for a dividend paid in relation to 2008-2009 or subsequently would then read:
Example 1:
On 15 December, Company A Ltd pays a dividend of $700 to a shareholder resident in Australia. The dividend is fully imputed, so that an imputation credit of $300 is available. NRWT of $105 is deducted from this dividend so that the net dividend paid is $595. The NRWT is paid to Inland Revenue on or before the following 20 January. On the following 15 February, the company paid a supplementary dividend to the shareholder, calculated as follows:

$300 \times 0.411806 = $123.53

NRWT amounting to $18.53 is deducted from this supplementary dividend so that the net amount paid was $105. The NRWT is paid to Inland Revenue on or before the following 20 March. The total NRWT deducted from the two dividends is $123.53 which is the amount of the supplementary dividend, and is the same amount that the company can claim against its income tax liability in its income tax return.

In a transitional period from the start of the 2008-2009 income year until 31 March 2010 a company may choose to attach imputation credits to dividends up to the higher imputation ratio of 33/67 [see 670.45]. Generally, during the transitional period, the current formula (ie the pre 2008-2009 formula) should be used to the extent the higher ratio is legitimately applied [s OZ 12].

(2) FITC calculation for 2007-2008 and earlier income years
The supplementary dividend is calculated according to the following formula:

attached imputation credit × (67 / 187)

Where “attached imputation credit” is the amount (if any) attached to the dividend.

However, the combined total of the imputation credit attached to the dividend and the foreign investor tax credit together must not exceed the maximum imputation ratio (33/67) as specified in s OA 18. Therefore, the supplementary dividend can be more simply calculated by multiplying the actual amount of imputation credit allocated to the dividend by the figure of 0.358275 [see TIB vol 7:11 (March 1996) at 24-25].

Example 2:
On 15 December, Company A paid a dividend of $670 to a shareholder resident in Australia. The dividend is fully imputed, so that an imputation credit of $330 is available. NRWT of $100.50 was deducted from this dividend so that the net dividend paid was $569.50. The NRWT is paid to Inland Revenue on or before the following 20 January. On the following 15 February, the company paid a supplementary dividend to the shareholder, calculated as follows:

$330 \times 0.358275 = $118.23

NRWT amounting to $17.73 was deducted from this supplementary dividend so that the net amount paid was $100.50. The NRWT is paid to Inland Revenue on or before the following 20 March. The total NRWT deducted from the two dividends is $118.23 which is the amount of the supplementary dividend, and is the same amount that the company can claim against its income tax liability in its income tax return.

NRWT is deducted at the rate of 15 per cent because the dividend is fully imputed. Note that the supplementary dividend is equal to the NRWT liability. Company A will reduce its own income tax liability for the year by the amount of the supplementary dividend paid.

Example 2 illustrates the overall effect of the foreign investor tax credit on the tax paid by a company and the tax paid by a non-resident shareholder, for a fully imputed dividend.

### 1010.30 Tax credits to companies for dividends paid to non-resident investors [ss LP 2, LP 3]
If a company resident in New Zealand has paid a dividend and a single supplementary dividend to a non-resident in any income year, the company is entitled to a credit against its income tax liability equal to the amount of the supplementary dividend [see 1010.20]. This applies to dividends paid on or after 12 December 1995. The FITC is equal to and calculated in exactly the same way as the supplementary dividend. The tax credit is allowed in the income year in which the supplementary dividend is paid (which must be in the same year as the main dividend was paid).

A s LP 7 holding company [see 1010.50] may elect to reduce the amount of credit applied against its income tax liability to an amount not less than the amount of supplementary dividends derived in that income year. If a part of the tax credit cannot be credited against the income tax liability for the year in which the supplementary dividend was paid, or if the amount credited is reduced by a s LP 7 holding company as above,
the company can elect that the excess credit be set off against any other income tax liability of the company, or an income tax liability of another company [see 1010.31].

If there are still excess credits available, the company can carry forward the excess credit to a later income year [see 1010.32].

1010.31 Offset of excess credit between group companies [s LP 3]

If the whole of the FITC cannot be set off against the company’s income tax liability for the year in which the supplementary dividend was paid, the company can elect, by notice in writing to the CIR with the company’s income tax return for the year that the excess FITC be set off against:

(a) The income tax liability of another company in the same wholly-owned group for the income year in which the supplementary dividend is paid; or

(b) The company’s income tax liability for any of the four preceding income years (not being a year earlier than the 1993-1994 income year); or

(c) The income tax liability of another company in the same wholly-owned group for any of the four preceding income years (not being a year earlier than the 1993-1994 income year).

For items (b) and (c) above, if one of the group companies exists for only part of an income year, the FITC can still be offset provided both companies were in the same wholly-owned group at all times during the income year in which both companies exist.

1010.32 Carrying forward excess credits [ss LP 3, LP 4]

If an excess credit is unable to be utilised as set out in 1010.31, the company may carry the excess credit forward to the succeeding or a later income year. Excess credits can be carried forward only if there is a group of persons:

(a) Whose total minimum voting interests in the company from the beginning of the original income year to the end of the year of carry forward (the “continuity period”) is equal to or greater than 49 per cent; and

(b) Where at any time during the continuity period a market value circumstance exists, whose total minimum market value interests in the company in the continuity period is equal to or greater than 49 per cent.

The minimum voting interest or minimum market value interest of any person in the company in the continuity period is the lowest voting interest or market value interest in the company that that person has during the continuity period.

An excess credit carried forward in this way must first be offset against the income tax liability of the company for the year of carry forward, after allowing for any credit under subpart LJ for foreign taxes paid.

If there are still remaining credits at this stage, the company can elect that the excess credit be set off against the income tax liability for the year of carry forward of any other company that is in the same wholly-owned group of companies for both the year of carry forward and the original income year. The election is made by giving notice in writing to the CIR with the company’s income tax return for the year of carry forward.

Any credits offset in any of the ways explained in 1010.31 or 1010.32 cease to be available for carry forward or offset in any other way.

1010.40 Benchmark dividend [s LP 5]

The benchmark dividend provisions governing the attachment of imputation credits and FDP credits to dividends, and the anti-avoidance provisions of ss GB 35 and GB 36, apply as if the company had never paid a supplementary dividend.

In applying the maximum imputation credit ratio and benchmark dividend provisions governing the attachment of imputation credits to dividends, and the anti-avoidance provisions, the imputation credit attached to the dividend is increased by the amount of the FITC. The effect of these provisions is to allow...
the supplementary dividend to be paid with no imputation credits or with different levels of imputation credits attached without breaching the anti-streaming rules.

1010.45 Payment of supplementary dividend not to contravene company or trust law [s LP 6]

The payment of a supplementary dividend by a company to all its non-resident shareholders is not treated as contravening:

(a) Any provision of the Companies Act 1955, or s 53 of the Companies Act 1993;
(b) Any provision of the company’s articles of association or constitution (other than a provision which expressly refers to s LP 6); or
(c) Any rule of law,

that would otherwise prohibit the company from paying different amounts in relation to shares of that class. If a trustee derives a dividend and is required under the terms of the trust to distribute it as beneficiary income to a beneficiary, the distribution by the trustee of the supplementary dividend to the same beneficiary is not to be treated as contravening any term of the trust.

1010.50 Special rules for holding companies [ss LP 7, LP 8, LP 9, LP 10, DX 3, YA 1]

Special rules apply to holding companies where a New Zealand holding company has an insufficient tax liability to utilise the FITC credit arising from paying its own supplementary dividend to its own non-resident shareholders. This could occur when a foreign investor holds less than 100 per cent interest in a New Zealand subsidiary through a New Zealand holding company and the holding company derives income only in the form of fully imputed dividends. Therefore, without any remedy, the FITC cannot be applied by the holding company when it pays a dividend to the non-resident. As the subsidiary is not wholly owned by the holding company, the FITC cannot be allocated to the subsidiary.

The remedy is that the holding company which is not a member of a consolidated group can become classified as a supplementary dividend holding company. This enables the holding company to be treated for the purposes of dividends and supplementary dividends as if it were a non-resident. Therefore, the New Zealand resident subsidiary company of a New Zealand holding company can pay a dividend to the holding company and consequently obtain the benefit of the FITC. The supplementary dividend holding company, in turn, now has a tax liability against which it can claim a FITC when it pays a supplementary dividend to a non-resident. A “supplementary dividend holding company” is defined as a company resident in New Zealand which has given a notice (which it has not revoked) to the subsidiary company paying the dividend within the previous seven years, before the dividend is paid. The supplementary dividend holding company shall have a purpose in the notice of directly or indirectly enabling the payment of a supplementary dividend to its non-resident shareholder. At least one voting interest in the supplementary dividend holding company shall be held by non-residents, and the supplementary dividend holding company shall derive dividends that are not excluded or exempt income. Such dividends shall be taxable.

The consequences are that the dividend and the supplementary dividend derived by the supplementary dividend holding company from the subsidiary company will be treated in the manner as if the supplementary dividend holding company were not resident in New Zealand. The dividend exemption applicable to wholly owned group companies under s CW 10 that would otherwise apply to a holding company is limited, so that the supplementary dividend holding company will derive assessable income calculated using the formula:

\[
\text{Assessable income} = (\text{attached credit} + \text{dividend}) \times \left(\frac{1 - \text{tax rate}}{\text{tax rate}}\right) + \text{attached credit}
\]

Where:

“Attached credit” is the amount of imputation credit attached to the dividend;

“Dividend” is the amount of the supplementary dividend; and
“Tax rate” is the basic rate of income tax for companies, expressed as a percentage, for the income year (currently 30 per cent).

The maximum amount of net losses (if any) that the supplementary dividend holding company may offset against its net income for the year is the amount calculated under the formula:

\[
\text{company’s income} - \frac{(\text{company’s total credits} + \text{supplementary amount})}{\text{tax rate}}
\]

Where:
“Company’s income” is the income for the income year corresponding with the tax year;
“Company’s total credits” are the supplementary dividend holding company’s total amount of specified tax credits;
“Supplementary amount” is the supplementary dividends derived;
“Tax rate” is the basic rate of income tax for companies, expressed as a percentage, for the income year (currently 30 per cent).

Special timing issues for when the dividend is derived may be arranged if the supplementary dividend holding company and the company paying the dividend are associated persons (as defined in subpart YB but as if each reference to “50 per cent or more” instead reads “more than 50 per cent”) and if the supplementary dividend holding company has an earlier income tax balance date than the company paying the dividend. The tax credit will apply as if the income year in which the company pays the dividend were the later income year of the supplementary dividend holding company.
Chapter 1020
Non-resident Withholding Tax

1020.10  Imposition of non-resident withholding tax [s RF 1]

Any person who derives “non-resident passive income” (NRPI) is liable to pay non-resident withholding tax (NRWT) on that income at the rates set out in 1020.20. NRPI consists of dividends, interest and royalties derived from New Zealand by non-residents [see 1020.15 for definition]. It is the person who pays the NRPI that is liable to deduct NRWT from that income and pay it to Inland Revenue.

For most forms of NRPI, NRWT is the final tax on that income, and the recipient has no further income tax obligations in relation to that income [see 1020.70]. However, in the case of interest paid to associated persons, commercial and industrial royalties, and know-how payments, NRWT is only a minimum tax. In this case, the recipient may have further tax to pay [see 1020.75].

1020.15  Definitions [ss RF 2, CC 9]

“Non-resident passive income” (NRPI) means income derived from New Zealand by a non-resident that consists of:

(a) Dividends (excluding investment society dividends);

(b) Royalties; or
Non-resident Withholding Tax

(c) Investment society dividends or interest when the non-resident is not engaged in business in New Zealand through a fixed establishment in New Zealand.

“Dividend” is defined in ss CD 3 to CD 21 [see 270.20] and, for NRWT purposes, includes:

(a) A “foreign dividend payment” (FDP) credit (but not an imputation credit) attached to the dividend; or

(b) An amount paid to a company shareholder, where that company is related to the company paying the amount, if the amount is excluded from dividend treatment generally only as a result of ss CD 26 and CD 44.

“Royalty” is defined in s CC 9 [see 1290.10].

“Interest” means a payment made to a person by another person for money lent, whether or not the payment is periodical and however it is described or computed. Interest does not include a repayment of the money lent. Interest includes:

(a) A redemption payment for a commercial bill; or

(b) Interest paid by the CIR under Part 7 of the TAA. NRWT deductions made by the CIR from that interest are deemed to have been paid to the CIR on the date the deduction is made [s RF 2, see TES 21 (November 2004) 303].

NRWT is not required to be deducted from interest payable under the approved issuer levy scheme [see 1020.80]. The following are not NRPI:

(a) Exempt income;

(b) Income derived under s CV 17 by non-residents from renting films [see 460.60] or CX 56 in relation to portfolio investor allocated income and distributions of income by portfolio investor entities;

(c) Income calculated under the financial arrangements rules.

1020.20 Non-resident withholding tax rates [ss RF 7, RF 8, RE 11B, RF 12]

The rates of “non-resident withholding tax” (NRWT) applicable to various forms of “non-resident passive income” (NRPI) are as follows:

<table>
<thead>
<tr>
<th>Type of NRPI</th>
<th>Rate of NRWT</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Dividends, other than:</td>
<td></td>
</tr>
<tr>
<td>- Investment society dividends;</td>
<td>30%</td>
</tr>
<tr>
<td>- Supplementary dividends;</td>
<td></td>
</tr>
<tr>
<td>- Conduit tax relief additional dividends;</td>
<td></td>
</tr>
<tr>
<td>- Dividends to the extent fully imputed;</td>
<td></td>
</tr>
<tr>
<td>- Dividends to the extent fully FDP credited;</td>
<td></td>
</tr>
<tr>
<td>- Dividends to the extent fully conduit tax relief credited.</td>
<td></td>
</tr>
<tr>
<td>(b) Interest derived jointly by two or more persons, where at least one of those persons is a New Zealand resident.</td>
<td>The applicable RWT rate (see below for details)</td>
</tr>
<tr>
<td>(c) Interest paid by an approved issuer to a non-associated recipient for a registered security [see 1020.80].</td>
<td>0%</td>
</tr>
<tr>
<td>(d) Non-cash dividends to the extent fully imputed.</td>
<td>0%</td>
</tr>
<tr>
<td>(e) Dividends to the extent the payment is a fully imputed dividend paid to a non-resident shareholder if:</td>
<td></td>
</tr>
<tr>
<td>- the non-resident has a 10% or more direct voting interest in the company:</td>
<td></td>
</tr>
</tbody>
</table>

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Non-resident Withholding Tax

**Type of NRPI** | **Rate of NRWT**
--- | ---
(f) - the non-resident has a less than 10% voting interest in the company and, and a DTA would otherwise reduce the NRWT rate to less than 15% | 0%
(g) NRPI derived by a life insurer from a New Zealand resident company deemed to exist as a result of the life insurer making an election under EY 49 [see 800.20]. | 0%
(h) All other NRPI, including: | 15%
- Interest other than (b) and (c);
- Royalties;
- Investment society dividends;
- Conduit tax relief additional dividends;
- Dividends to the extent fully imputed;
- Dividends to the extent fully FDP credited;
- Dividends to the extent fully conduit tax relief credited.

The rate at which NRWT is deducted from a payment of NRPI is lower if the person deriving the income is a resident of a country with which New Zealand has a double tax agreement [see 1020.25].

**1020.25 Non-resident withholding tax rates for DTA countries**

The following table summarises the rates of NRWT applicable to residents of double tax agreement countries, for each type of non-resident passive income (NRPI). It is important that the relevant double tax agreement is consulted before applying any of these rates, because the conditions vary from agreement to agreement.

<table>
<thead>
<tr>
<th><strong>Country of residence</strong></th>
<th><strong>Interest or royalties</strong></th>
<th><strong>Interest paid to associated persons</strong></th>
<th><strong>Dividends</strong></th>
<th><strong>Royalties</strong></th>
<th><strong>Copyright (cultural) royalties</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>10%/5% (1)</td>
<td>15% Min</td>
<td>15% (1)</td>
<td>15% Max</td>
<td>15%</td>
</tr>
<tr>
<td>Belgium</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Canada</td>
<td>15%</td>
<td>15% Max</td>
<td>15%</td>
<td>15% Max</td>
<td>15%</td>
</tr>
<tr>
<td>Chile</td>
<td>10%</td>
<td>15% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>China</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Denmark</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>100% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Fiji</td>
<td>10%</td>
<td>15% Min</td>
<td>15%</td>
<td>15% Max</td>
<td>15%</td>
</tr>
<tr>
<td>Finland</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>France</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Germany</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>India</td>
<td>15%</td>
<td>15% Max</td>
<td>20%</td>
<td>15% Min</td>
<td>15%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>15% Max</td>
<td>15%</td>
</tr>
<tr>
<td>Ireland</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Italy</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Japan</td>
<td>15%</td>
<td>15% Min</td>
<td>15%</td>
<td>15% Min</td>
<td>15%</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
</tbody>
</table>

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### Non-resident Withholding Tax

<table>
<thead>
<tr>
<th>Country of residence</th>
<th>Interest or royalties</th>
<th>Interest paid to associated persons</th>
<th>Dividends</th>
<th>Royalties</th>
<th>Copyright (cultural) royalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>15%</td>
<td>15% Min</td>
<td>15%</td>
<td>15% Max</td>
<td>15%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Norway</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Philippines</td>
<td>15%</td>
<td>15% Max</td>
<td>(3)</td>
<td>15% Max</td>
<td>15%</td>
</tr>
<tr>
<td>Russia</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Singapore</td>
<td>15%</td>
<td>15% Min</td>
<td>15%</td>
<td>15% Max</td>
<td>15%</td>
</tr>
<tr>
<td>South Africa</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Sweden</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Thailand (see DTA)</td>
<td>15%</td>
<td>15% Max</td>
<td>15%</td>
<td>10% or 15% Max</td>
<td>10%</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>United Kingdom (4)</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>United States</td>
<td>10%</td>
<td>10% Max</td>
<td>15%</td>
<td>10% Max</td>
<td>10%</td>
</tr>
<tr>
<td>Other countries</td>
<td>15%</td>
<td>15% Min</td>
<td>30%</td>
<td>15% Max</td>
<td>15%</td>
</tr>
</tbody>
</table>

**Notes:**

1. The rates listed for Australia are the general rates. The latest DTA with Australia now provides the following rates if the conditions stipulated apply.
   - **Dividends**
     - Dividends shall not be taxed when the beneficial owner of the dividend is a company that has owned, directly or indirectly (through one or more residents of either Australia or New Zealand) shares representing 80 per cent or more of the voting power of the company paying the dividend for a 12 month period. The company that is the beneficial owner of the shares must be either a listed Australian or New Zealand resident company or a combination. There is also a facility in para 3 of art 10 for the CIR to issue a determination that the first sentence in para 9 of art 10 does not apply.
     - 5 per cent when the beneficial owner of the dividends is a company which holds at least 10 per cent of the voting power of the paying company.
   - **Interest**
     - Interest may not be taxed when paid to the central or local government or a political subdivision. This includes a government investment fund and the central bank.
     - The interest may not be taxed when derived by an unrelated financial institution dealing at arm’s length with the payer. A financial institution is defined as a bank or other enterprise substantially deriving profits by debt finance or by taking deposits at interest and using those funds in carrying on a business of providing finance. Note that, in this context, the interest will be subject to tax at 10 per cent if approved issuer levy is not paid or when the interest is paid as part of an arrangement of back-to-back loans.
     - Royalties are taxed at 5 per cent.
2. The rates listed for the United States are the general rates. The latest DTA with the United States now provides the following rates if the conditions stipulated apply.
Dividends

- 5 per cent when the beneficial owner of the dividends is a company which holds at least 10 per cent of the voting power of the paying company.
- Dividends shall not be taxed when the beneficial owner of the dividend is a company that has owned, directly or indirectly (through one or more residents of either the United States or New Zealand) shares representing 80 per cent or more of the voting power of the company paying the dividend for a 12 month period.
- The company that is the beneficial owner of the shares must be:
  - Either a listed Australian or New Zealand resident company or a combination. There is also a facility in para 3 of art 10 for the CIR to issue a determination that the first sentence in para 9 of art 10 does not apply.
  - At least 50 per cent of the aggregate voting and ownership of the shares is owned directly or indirectly by five or fewer companies resident in either country.
  - A non-individual if, on at least half of the days in the year, is entitled to the benefits of the United States DTA, owns at least 50 per cent of the aggregate voting power and value of the payer, provided that in the case of indirect ownership, each intermediate owner is a resident of the United States. Further, less than 50 per cent of the gross income of the paying company must not be paid to non-resident owners resident in a country other than the USA - excluding arm’s-length payments.

Interest

- Interest may not be taxed when paid to the central government or an instrumentality of that government which is not subject to tax and, interest may not be taxed if derived by a resident of the United States with respect to debt obligations guaranteed or secured by the government or an instrumentality, which is not subject to tax.
- The interest may not be taxed when derived by a bank or enterprise substantially deriving its income from lending or finance on transactions with unrelated parties.
- Note that, as with Australia, New Zealand may impose tax at 10 per cent if approved issuer levy is not paid or when the interest is paid as part of an arrangement of back-to-back loans.
- Royalties are taxed at 5 per cent.

(3) 15 per cent for companies; 25 per cent for other taxpayers.

(4) Excluding the Isle of Man and the Channel Islands.

Min  This means the rate shown is a minimum rate of tax. The net income (after deducting expenses) must be included in the non-resident’s tax return, along with all other income from New Zealand. Credit is allowed for the NRWT deducted.

Max  The tax on the income cannot exceed the rate shown.

1020.30  Who must deduct non-resident withholding tax  [ss RF 3, RF 4]

Persons making payments of non-resident passive income (NRPI) must deduct NRWT from the gross amount of income, before paying the balance to the recipient. To “pay” [s YA 1] includes:

(a) Distributing the amount to a person;
(b) Crediting it to a person; or
(c) Dealing with it in the person’s interest or on behalf of a person, or in some other way.

Where a New Zealand agent receives a payment of NRPI on behalf of a non-resident, and the required NRWT has not been deducted or only partly deducted, the New Zealand agent must deduct the shortfall. Where NRPI has had NRWT deducted before payment to the New Zealand agent, the payer must give notice to the agent of the amount deducted. This avoids the possibility of a double deduction. Notice must be given by one of the methods specified in s 14B of the TAA.
Non-resident Withholding Tax

Inland Revenue has the discretion to meet special circumstances by relieving any person from the obligation to deduct NRWT, or varying the amount of the NRWT to be deducted.

1020.35 Exemption from non-resident withholding tax

Some non-resident individuals or organisations are entitled to be paid non-resident passive income (NRPI) in full without having NRWT deducted. Unlike the exemption for resident withholding tax (RWT), certificates of exemption are not issued. Inland Revenue provide the payer with a letter granting the exemption.

The Non-resident Centre (based in Dunedin) processes requests from overseas organisations to exempt their NRPI income (derived from New Zealand sources) from tax. The main reason these organisations request an exemption is that, because they have tax-exempt status in their countries of residence, they believe it should extend to other countries from which they derive income.

New Zealand tax laws do not automatically exempt organisations or their income from New Zealand tax simply because an exemption exists in their own countries of residence. However, overseas organisations can be considered for exemption from NRWT if any of these conditions are met:

(a) Income is specifically exempted from income tax, including NRWT, under New Zealand tax law;
(b) Income is exempted from income tax by any other New Zealand legislation; or
(c) Double tax agreements expressly provide for an exemption from tax on certain types of income.

See Inland Revenue Booklet, Non-Resident Withholding Tax – Payer’s Guide (IR291)

1020.40 Calculation of NRWT on cash dividends

Non-resident withholding tax (NRWT) is deducted from cash dividends at the rate specified in 1020.20 and 1020.25.

If a dividend is not fully imputed, or not fully FDP credited, the extent to which it is fully imputed or credited must be determined.

(1) Extent to which dividend fully imputed

The extent to which a dividend is fully foreign dividend payment credited is calculated using the following formula:

\[
\text{Extent to fully imputed} = \left( \text{Imputation credit amount} + \text{Supplementary dividend amount} \right) \times \left( 1 - \frac{\text{tax rate}}{\text{tax rate}} \right)
\]

Where:

“Imputation credit” amount is the amount of imputation credits attached to the dividend;

“Supplementary dividend” amount is the amount of supplementary dividend payable as a result of subpart LP for the dividend; and

“Tax rate” is the basic rate of income tax for companies for the tax year that is concurrent with the tax year in which the dividends are paid.

Example:

A cash dividend of $100 is paid to a non-resident. Imputation credits of $20 are attached to the dividend. Assume that there is no applicable double tax agreement and no supplementary dividend has been paid. The extent to which the dividend is fully imputed is calculated as follows:

\[
\left( \frac{20 + 0}{0.72} \right) \times \frac{0.28}{0.28} = 51.43
\]

The dividend is not fully imputed to the extent of $48.57 ($100.00 – $51.43). The company paying this dividend must deduct NRWT of $22.28, calculated as follows:

\[
(51.43 \times 15\%) + (48.57 \times 30\%) = 22.28
\]

(2) Extent to which dividend fully FDP credited

The extent to which a dividend is fully FDP imputed is calculated using the following formula:
FDP credit amount / tax rate

Where:
“FDP credit” amount is the amount of FDP credits attached to the dividend; and
“Tax rate” is the basic rate of income tax for companies for the tax year that is concurrent with the tax year in which the dividend is paid.

Example:
A cash dividend of $100 is paid to a non-resident. Imputation credits of $20 and FDP credits of $10 are attached to the dividend. Assume that there is no applicable double tax agreement and no supplementary dividend has been paid. The extent to which the dividend is fully imputed is $51.43 as calculated in the previous example. The extent to which the dividend is fully FDP credited is calculated as follows:

\[
10 / 0.28 = $35.71
\]

The gross amount of the dividend is $110 (the cash amount of $100 plus the FDP credits of $10). The company paying this dividend must deduct NRWT of $ calculated as follows:

\[
[(51.43 + 35.71) \times 15\%] + [(110.00 − 51.43 − 35.71) \times 30\%]
\]

= 13.07 + 6.86 = $19.93

NRWT is imposed on the gross amount of a dividend. The “gross” amount means without any deduction whatsoever from the amount.

In Lambe v Commissioner of Inland Revenue (1980) 4 NZTC 61,599, (1980) 4 TRNZ 65 (HC), the taxpayer unsuccessfully claimed that legal expenses she had incurred to establish her right to receive the interest payments should be deducted in arriving at the amount on which the NRWT was payable. See also Fleming v Commissioner of Inland Revenue (1983) 6 NZTC 61,517, (1983) 6 TRNZ 6 (HC).

1020.42 Calculation of NRWT on non-cash dividends [s RF 10]

A non-cash dividend means a dividend to the extent that it does not consist of an unconditional payment in money or an unconditional credit in money to the balance of a shareholder’s current (or other form of) account with the company [see 270.50]. Examples of non-cash dividends provided to non-resident shareholders include:

(a) A taxable bonus issue;
(b) A dividend paid in kind (property distributed to a shareholder for nil consideration);
(c) Property sold or otherwise disposed of to the shareholders at less than market value; or
(d) Distributions or transactions by a close company to a shareholder or an associated person of a shareholder.

(1) Taxable bonus issues

The amount of NRWT to be deducted from a non-cash dividend (to the extent that it is not fully imputed) is calculated using one of the following formulae:

\[
(\text{rate } \text{A} \times \text{dividend payment}) + (\text{rate } \text{B} \times (\text{amount paid} + \text{credit amount})).
\]

Where
“Rate A” is 30 per cent, or the rate specified in any applicable double tax agreement;
“Dividend payment” is the amount of the dividends calculated under s CD 7(2) or CD 8(3) (which relate to bonus issues), either other than dividends referred to in the item “bonus issue” or to the extent to which it is neither fully imputed or fully credited for [see 1020.40] and before any deduction of NRWT;
“Rate B” is 15 per cent (ie the rate set out in s RF 7);
“Amount paid” is the amount of the dividends calculated under ss CD 7(2) or CD 8(3) together with the amount of any FDP credit attached to the dividends to the extent to which it is fully FDP credited and before any deduction of NRWT;
“Credit amount” is the amount of the dividends, to the extent to which it is fully credited for conduit tax relief plus the conduit tax relief additional dividends paid for the taxable bonus issue.
(2) **Non-cash dividends other than taxable bonus issues**

\[
\text{NRWT = \left( \frac{\text{rate } A}{1 - \text{rate } A} \right) \times \text{dividend payment} + (\text{rate } B \times \text{amount paid}).}
\]

Where:

“Rate A” is:

(a) for a CTR [see 215.10] 15 per cent, (ie the rate set out in s RF 7) additional dividends or dividends to the extent they are fully conduit tax relief credited; or

(b) in any other case, zero per cent, or the rate specified in any applicable double tax agreement;

“Dividend payment” is the amount of the dividend paid, to the extent to which the dividend is neither fully imputed or fully FDP credited, and disregarding any deduction of NRWT;

“Rate B” is 15 per cent, (ie the rate set out in s RF 7); and

“Amount paid” is the amount of the dividend paid, to the extent it is fully FDP credited, and disregarding any deduction of NRWT.

In determining the extent to which a dividend is fully conduit tax relief credited, an amount that must be deducted from a non-cash dividend to the extent fully conduit tax relief credited is treated as being part of the non-cash dividend.

Although there is a requirement under s RF 3 to deduct NRWT from non-cash dividends, in reality it cannot be deducted because there is no payment in money from which to deduct it. Instead, the company providing the dividend is liable to make a payment to the CIR of an amount equal to the NRWT that would otherwise have to be deducted.

1020.45 **Head office charges**

(1) **New Zealand business is branch of overseas firm**

When a New Zealand business is a branch of an overseas firm NRWT is not payable except on the proportion of any interest payable by the overseas company to non-resident lenders and included in the head office expenses charged to the New Zealand branch (see separate heading) because the loan is then being used for the business carried on by the New Zealand branch. Apart from any question of NRWT Inland Revenue must be satisfied that the claim against the New Zealand profits is reasonable. A claim for a percentage of sales at a fixed rate each year is generally unacceptable unless the firm can show that a factual result is produced. A more satisfactory way to work out head office expenses for New Zealand tax purposes is to:

(a) Adjust head office expenses of the firm’s world activities to include only those items deductible under New Zealand tax law; and

(b) Claim the adjusted expenses against the New Zealand income in the proportion that New Zealand sales bear to total world sales.

The claim for head office expenses should be supported if required at any time by a statement from the firm’s auditors showing:

(a) That the expenses are normal revenue expenditure;

(b) That items of a capital nature are excluded; and

(c) The proportion of New Zealand sales to world sales.

(2) **New Zealand business is a subsidiary of overseas company**

When the New Zealand business is a subsidiary of an overseas parent company NRWT could be payable because there is a payment between two separate firms. Questions to be considered are:

(a) Is the claim by the subsidiary in arriving at its own profits excessive? The rules set out previously should be followed; and

(b) Is there an income content in the payment to the parent company? If so the total payment could be liable to NRWT. Inland Revenue has stated this liability can be avoided by limiting the charges against New Zealand profits to a mere reimbursement of the New Zealand share of the head office
Non-resident Withholding Tax

revenue charges. The parent company can do this by basing its claim for head office expenses (adjusted to exclude items not deductible under New Zealand tax law) on the proportion of New Zealand sales to total world sales rather than on a flat percentage of New Zealand sales [see PIB 29 (February 1966)].

(3) Interest content in head office charges

Where the non-resident company charges its New Zealand branch with a proportion of the interest it pays for loan money to overseas lenders, Inland Revenue has ruled that the proportion of interest so charged to the New Zealand branch has a source in New Zealand (under s YD 4), and so the branch must deduct and account for NRWT based upon the proportion of interest so included in the head office charges. It is considered that the branch is part of the entity and therefore assumed to be using that part of the loan capital for which it is charged a proportion of the interest. If, in fact, the branch is not using a portion of the loan capital (and is thus wrongly charged by the head office), the interest will be disallowed in calculating the branch profit for New Zealand income tax purposes. In that case the interest will not be liable to the NRWT.

Interest included in the head office charges of a New Zealand subsidiary of a non-resident parent company is in a different category. The New Zealand subsidiary is a separate entity, and does not participate in the parent company’s loan capital, and is merely paying for a service it receives, and consequently the interest content is not liable to NRWT.

1020.47 Shares sold to associated company [s RF 11]

Where a non-resident, who controls (or is one of the persons deemed to control) a New Zealand company, sells his or her shares in the company to another New Zealand company which is also controlled by the non-resident, so long as any part of the purchase price is unpaid (whether or not secured by mortgage) any dividend paid by the former company in favour of the latter company is deemed to be derived by that non-resident shareholder to the extent that the price is unpaid, and is subject to the “non-resident withholding tax” (NRWT).

1020.50 Non-resident software suppliers

The income tax treatment of payments made to non-resident software suppliers is explained in an Inland Revenue interpretation guideline [see TIB vol 15:11 (November 2003) at 8-24]. Only the NRWT aspects of the guideline are summarised here.

NRWT applies only to payments that constitute royalties derived from New Zealand by non-residents [see 1290.10 for definition of “royalty”].

The Inland Revenue interpretation guideline addresses the following software transactions:

(a) Sale of a copyright right in a computer program: The sale of a copyright right in a computer program results in the alienation of the ownership of the rights. The consideration is not for “the use of the rights” and therefore not a royalty. No NRWT liability arises in this situation.

(b) Licence of a copyright right in a computer program: The granting of a licence to use software copyright results in only a partial transfer of rights. The consideration for the licence is for the use of, or the right to use, the copyright, and is therefore a royalty. If the payment is deemed (under s YD 4) to be derived from New Zealand, it will be subject to NRWT.

(c) Sale of a copy of a computer program: The sale of a copyrighted program (eg the sale of a prepackaged copy of a program) generally does not include a supply of copyright. The purchaser has no right to use the copyright, only the right to use the copy of the program purchased. The consideration provided is therefore not a royalty and NRWT does not apply.

(d) Lease of a copy of a computer program: The lease of a copy of a computer program is a chattel lease, and the payments made under the lease are rental payments. As with the sale of a copy of a computer program, there is no transfer of the right to use the copyright, only the right to use the copy for the term of the lease. The income tax treatment will depend on the terms of the agreement. For example, non-resident contractors withholding tax may apply if the payment is made to a non-resident contractor [see 1320.20]. If the lease agreement falls within the definition of a “finance lease” [see 900.15], the interest component of the lease payments will be subject to NRWT.
Non-resident Withholding Tax

1020.55 Failure to deduct non-resident withholding tax [ss RF 6, RA 8, RA 10]

If the person who pays “non-resident passive income” (NRPI) fails to deduct NRWT, or does not deduct enough NRWT, the CIR will normally require the payer to either deduct the shortfall from a subsequent payment to the same payee, or pay the shortfall and then recover it from the payee [see 1020.56]. If the shortfall is identified in the annual reconciliation, payment of the shortfall must be made by the due dates specified in 1020.64. However, the CIR is also able to recover the shortfall from the payee directly, if necessary.

(1) Recovery from person deriving NRPI

Where, for any reason, a person paying NRPI fails to deduct NRWT, or fails to deduct it in full, the recipient of the payment becomes liable to pay the deduction (or the shortfall in the deduction) that should have been made [s RA 8].

(2) Recovery from person paying NRPI

Where a person fails to make a deduction of NRWT from a payment of NRPI or a non-cash dividend, the amount in default constitutes a debt payable to the CIR, and is due and payable under s RA 10 as if the deduction had been made [see 1020.60]. The right of the CIR to recover the amount in default from the payer of the NRPI is in addition to the right to recover it from the payee. The CIR may recover the amount from both persons concurrently, from one of those persons alone, or partly from one and partly from the other. Any amount recovered by the CIR from the payer of NRPI may be recovered by the payer from the payee.

1020.56 Variation in NRWT deductions to correct errors [ss RA 11, RA 12]

A person who has failed to deduct “non-resident withholding tax” (NRWT) from a payment of non-resident passive income (NRPI), or deducts too little, may (unless the shortfall has already been deducted by another person) either:

(a) Deduct the deficiency from any subsequent payment of NRPI to the same person in the same year; or

(b) Recover the deficiency from the non-resident in some other way.

A person who deducts too much NRWT from a payment of NRPI may either reduce any subsequent payments of NRWT to the CIR by that excess or apply for a refund [see 1020.57], if:

(a) The excess has been paid to the CIR;

(b) The excess is due to an error on the part of the person making the deduction; and

(c) The person has subsequently refunded the excess to the non-resident.

However, if the payer deducts too much NRWT from a payment of NRPI as a result of an act or omission on the part of the recipient, the payer must pay the full amount to the CIR and is not liable to refund the excess to the recipient of the NRPI.

1020.57 NRWT over-deducted [s RA 19]

When a person has deducted too much NRWT and paid it to the CIR, the CIR must refund the excess. If the person who made the excess deduction has since paid back the excess to the non-resident (and not offset it
against subsequent payments of NRWT to the CIR), the excess will be refunded to that person. Otherwise the excess is refunded to the non-resident.

The CIR may apply the excess in payment of any outstanding tax due by the person entitled to the refund. If the CIR refunds NRWT in error, the CIR may recover the excess as if it were income tax payable. The excess refund must be repaid by the fifth of the month following the month in which the person is notified of the error. If the excess refund occurred because of wilful default or neglect by the taxpayer, penalties and interest will be charged from the day after the refund was originally paid by the CIR.

**1020.60 Payment of non-resident withholding tax** [ss RF 13, RA 15]

Deductions of NRWT must be paid to Inland Revenue on a monthly basis not later than the 20th day of the month following the month of deduction. However, a person who estimates that their aggregate NRWT deductions for a tax year will be less than $500 may pay the deductions on a six monthly basis as follows:

(a) On 20 October for all deductions made during the period 1 April to 30 September (both dates inclusive) in the tax year; and

(b) On 20 April for all deductions made during the period 1 October to 31 March (both dates inclusive) in the tax year.

Where the $500 aggregate is reached at any time during a tax year, all subsequent payments of NRWT to Inland Revenue must be made on a monthly basis.

Where a person ceases to carry on a taxable activity for which NRWT deductions have been required, or ceases to carry on any such taxable activity in New Zealand, all outstanding NRWT deductions must be paid to Inland Revenue by the 20th day of the month following the month in which such activity ceased. The CIR may extend the time for payment of NRWT.

**1020.62 Penalties**

Late payment penalty [TAA, s 139B] and interest [TAA, Part 7] apply to any failure to deduct or pay NRWT to the CIR [see 1110.40, 1110.290 and 1110.295]. Late payment penalties and interest are not charged on outstanding amounts of $100 or less. Shortfall penalties may also apply to any person required to deduct and account for NRWT [see 1110.85 to 1110.185].

**1020.64 Annual reconciliation** [s RA 6; TAA, s 49]

Every person who is required to deduct and pay NRWT must prepare and furnish to the CIR, not later than 31 May in the following year, a NRWT deduction certificate for all such deductions or payments made in relation to each recipient during the year. An annual reconciliation statement for all such deductions or payments made during the year is also required.

The NRWT deduction certificate must include the following information:

(a) The full name, address, and tax file number of the person making the deduction or payment;

(b) The full name, last known address, and tax file number of the recipient of the payment (except where, after making reasonable inquiries, the payer is unable to obtain such details);

(c) The country code of the recipient;

(d) The year to which the certificate relates;

(e) The type of non-resident passive income to which the deduction certificate relates;

(f) The amount of the NRWT deduction and the amount of the non-resident passive income to which the deduction relates;

(g) The amount of NRWT paid;

(h) The payer’s signature and date of signing; and

(i) Any other information required by the CIR.
The CIR may require further information to be provided in the annual reconciliation statement. Where the annual reconciliation statement identifies any unpaid deductions or payments, those unpaid amounts must be paid to the CIR no later than:

(a) 20 April following the end of the tax year; and

(b) The last day by which the information required in the deduction certificates is to be provided.

A person who ceases to carry on any taxable activity for which NRWT deductions have been required, or any such taxable activity in New Zealand, is required within 40 working days after the end of the month of cessation to prepare and furnish any NRWT deduction certificates and a final annual reconciliation statement.

Note: The CIR may vary any of the filing requirements set out above.

1020.66 Assessment of non-resident withholding tax

The assessment provisions in ss 109 to 111, 113 and 114 of the TAA [see 60 ASSESSMENTS] apply to assessments of NRWT, with appropriate changes in terminology.

The CIR may make an assessment of the amount of non-resident passive income (NRPI), and of the amount of NRWT payable on that income, for any person chargeable with NRWT. The person is liable to pay the tax so assessed, unless it can be established in challenge proceedings that the assessment is excessive or that the amount is not chargeable. The CIR also has a general power to make an assessment of the amount of NRWT that is payable.

An assessment of NRWT may be challenged under Part 8A in the same way as any tax imposed under s BB 1.

1020.70 Non-resident withholding tax — a final tax [s RF 2]

The amount of NRWT for which a person is liable is the final tax on the following types of non-resident passive income:

(a) Dividends, other than investment society dividends;

(b) Royalties for the use, production or reproduction of, or for the privilege of using, producing or reproducing, a literary, dramatic, musical or artistic work in which copyright subsists (commonly known as “cultural royalties”);

(c) Interest or royalties derived by a life insurer from a resident company deemed to exist as a result of the life insurer making an election under s EY 49;

(d) Interest or investment society dividends, where the person paying the income and the person deriving it are not associated persons [see 70.10 for definition of “associated person”).

This means that a non-resident deriving the above types of income does not need to include that income in a year-end tax return, and has no further income tax to pay on it over and above the NRWT already paid. If NRWT is the final tax for a dividend, the taxpayer is not entitled to a credit of tax for any imputation credit attached to the dividend.

Most double tax agreement’s state that NRWT on royalties is a final tax unless the non-resident recipient has a permanent establishment in New Zealand and those royalties are effectively connected to that permanent establishment.

1020.75 Non-resident withholding tax — a minimum tax [s RF 2]

Non-resident withholding tax (NRWT) is not the final tax for the following types of non-resident passive income:

(a) Interest and investment society dividends, where the person paying the income and the person deriving it are associated persons;

(b) Royalties other than cultural royalties (commonly referred to as “industrial royalties”) [see 1020.70].

In these circumstances, the person’s income tax liability for the tax year is the greater of:
(a) The sum of the NRWT payable on all non-resident passive income (NRPI) and the person’s income tax liability (as determined in an annual return) for other types of income; or
(b) The person’s income tax liability if the NRPI for which NRWT is not the final tax were included in the person’s annual return.

In calculating the person’s income tax liability under (b), a credit is allowed for the amount of NRWT deducted from the NRPI and paid to the CIR [s LA 8].

Example:
A company resident in Australia with a permanent establishment in New Zealand derives income from New Zealand during the year ended 31 March. In deriving net trading income the New Zealand operation was provided with technical know-how from the Australian resident, therefore establishing an effective connection between royalties paid and the New Zealand permanent establishment. The company is subject to art 12(4) of the Double Taxation Relief (Australia) Order 1995, which effectively says that NRWT will be a minimum tax if the contracting state (Australia) has a permanent establishment in the other contracting state (New Zealand), and the knowledge, information, assistance, right, or property giving rise to the royalties is effectively connected with that permanent establishment. Commercial royalties (trade marks) derived before expenses deducted amount to $2,560. NRWT deducted at 15 per cent amounts to $384. Other net income amounts to $3,440.

Annual return excludes NRPI
Net income $3,440
Income tax at company rates (30 per cent) $1,032
Add NRWT deducted at source $384
Total $1,416

Annual return includes NRPI
Commercial royalties, less 25 per cent expenses allowances $1,920
Net income $3,440
Income tax at company rates (30 per cent) $1,032
Less credit for NRWT deducted at source (as above) $384
Total $1,224

In the return including NRPI, the tax payable ($1,224) is less than the sum of the tax on the net trading income plus the NRWT on the royalties ($1,416). The amount of tax payable is therefore $1,224. Royalties would normally need to be effectively connected with the permanent establishment to give rise to assessment in New Zealand.

(1) Exception
NRWT on interest and investment society dividends paid to associated persons, and on industrial royalties, is the final tax on that income when derived by a non-resident company, and these forms of income (when combined with other assessable income) do not exceed $1,000.

1020.77 Industrial royalties
The 15 per cent NRWT on the gross payments of industrial royalties is, generally, a minimum tax. Unless limited by a double tax agreement, additional tax will be payable after the end of the financial year in which the royalties and payments were derived if tax assessed at annual rates on the net income after allowing deductible expenses exceeds the 15 per cent withholding tax.

Example:
(Income year ended 31 March)
Gross payment to non-resident company $8,000
Less expenses $2,000
Net income $6,000
Withholding tax on payments $1,200

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**Non-resident Withholding Tax**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual tax on net income (30 per cent)</td>
<td>$1,800</td>
</tr>
<tr>
<td>Less credit for withholding tax</td>
<td>$1,200</td>
</tr>
<tr>
<td>Payable in annual assessment</td>
<td>$600</td>
</tr>
</tbody>
</table>

### 1020.78 Allowable deductions against royalty income

Deductions are only allowed against royalties that are included in an annual tax return [see 1020.75]. It is recognised that non-residents may find it difficult to provide full details of the expenses applicable to royalties from New Zealand. To help these people Inland Revenue allows, as a minimum deduction in an annual assessment, the following percentages for expenses without supporting claims:

<table>
<thead>
<tr>
<th>Nature of payments</th>
<th>Percentage allowable</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Trade mark</td>
<td>25%</td>
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<tr>
<td>2. Patent</td>
<td>35%</td>
</tr>
<tr>
<td>3. “Know-how”</td>
<td>50%</td>
</tr>
<tr>
<td>4. Any combination of 1 or 2 above with 3</td>
<td>40%</td>
</tr>
</tbody>
</table>

The arbitrary expense allowance is made by Inland Revenue as a matter of administrative convenience only, and is not based on any specific statutory authority, although a deduction is generally allowable under s DA 1.

In *TRA Case B22 (1975)* 1 TRNZ 305, the objector, a non-resident company, in accordance with the above, claimed 50 per cent of the royalties as an expense allowance on the ground that the royalties were for “know-how” only, but Inland Revenue considered that they were for a combination of a payment for “know-how” and a payment for the use of trade marks, and reduced the claim to 40 per cent of the royalties. At the hearing, the objector pointed out that the only reference to trade marks in the agreement was in the schedule to the agreement and contended that the words were used there merely by way of description of the goods, and further contended that the Reserve Bank had approved of the quantum of the royalty on the basis that it was for “know-how”, not for trade marks. It was contended for Inland Revenue that the TRA had no jurisdiction to decide the matter since the allowance made was purely an arbitrary amount granted by Inland Revenue, and whether the deduction was 40 per cent or 50 per cent was non-judicable issue. However, the TRA decided that it had jurisdiction to consider the agreement to ascertain whether Inland Revenue had interpreted it correctly before arriving at its decision to allow 40 per cent as a deduction. The TRA decided as a fact that Inland Revenue had misconstrued the effect of the agreement, and that the royalty related solely to “know-how” and, accordingly, Inland Revenue had made the assessment in error.

If it is considered that actual expenses exceed the arbitrary allowance, a tax return, giving details to support the claim for the higher deduction, should be filed on behalf of the overseas recipient. In the first instance the claim should be supported by a certificate from an overseas auditor or chartered accountant setting out the amount and how it is arrived at.

The expenses of a non-resident in the production of industrial royalties and “know-how” from New Zealand may include, in addition to actual expenses in New Zealand, the proportion of:

(a) The expenses incurred in developing or acquiring the trade mark, patent, or “know-how”; and

(b) Administration and other overhead expenses.

The amount for development or acquisition will generally follow the treatment of this expenditure in the books of the non-resident recipient.

If expenditure on new or continuing research is charged direct to revenue accounts each year, the New Zealand proportion may be claimed even though the patent or knowledge used in New Zealand may have been developed some time in the past. On the other hand, if the original expenses were capitalised, the amount allowable would be the New Zealand proportion of the amount written off during the year.

Inland Revenue will consider requests that payments of NRPI be made without deduction of NRWT when:
(a) Tax has already been paid in annual assessments on the non-resident in past years; and
(b) The tax in an annual assessment exceeds the NRWT that would normally be deducted.
This variation will apply only to payments of industrial royalties and interest. Payments of dividends and cultural royalties are not included in an annual assessment and the deduction of NRWT is final.
Inland Revenue will also consider variations to provide for centralised accounting in one sum when numerous small payments of royalties, particularly cultural royalties, are made during the year.

**1020.80 Approved issuers [TAA, s 32M]**
Approved issuers may pay interest to non-residents without deducting NRWT. They are also eligible for certain exemptions under some double tax agreements. Under the NRWT rules, instead of deducting NRWT from a payment of interest, an approved issuer is required to pay a levy for the right to issue securities that are subject to a zero per cent rate of NRWT. The levy, known as the approved issuer levy, is calculated at the rate of two per cent of interest paid. The following conditions apply:
(a) The persons paying and receiving the interest cannot be associated persons;
(b) The interest must be paid by an approved issuer on a registered security; and
(c) The approved issuer levy must be paid by the due date.
The approved issuer levy regime cannot apply to:
(a) New Zealand residents and non-residents who have a fixed establishment in New Zealand deriving interest income, as they are not subject to the NRWT regime and are, instead, liable for income tax; and
(b) Interest payments to non-residents where the conditions for zero-rating are not satisfied.
Application for approved issuer status can be made using form IR396. One security can also be registered on form IR396 at the same time as applying for approved issuer status. Approval is granted and applies from the date the application was received unless the applicant has been in serious default or neglect with tax obligations during the period. Once a person has approved issuer status, the securities that will be subject to the approved issuer levy may be registered using form IR397 (the first security can be registered on form IR396).
A person’s approved issuer status may be revoked where there has been serious default or neglect with tax obligations. The revocation affects the person’s ability to issue new tax-free securities, not the status of existing securities. An approved issuer is also able to request that their status be revoked.
Borrowers (ie payers of interest) elect to pay the approved issuer levy in respect of a security by:
(a) Either being an approved issuer or becoming one; and
(b) Applying to register the security; and
(c) Paying the levy for the security.
The approved issuer levy is due for payment on the same date as NRWT [see 1020.60]. Payment is to be made using form IR67A. Failure to pay by that date will make the interest payment liable for NRWT to the extent that the approved issuer levy is deficient.

**Example:**
If the two per cent approved issuer levy on interest of $10,000, amounting to $200, is not paid by due date, the entire interest payment is due for NRWT, which is imposed on the payee and not on the issuer.

Inland Revenue has discretion to accept late payments of approved issuer levy where the delay was due to circumstances beyond the payer’s control. Penalties and interest will apply to any late payment of approved issuer levy.
Chapter 1030

Official Information and Secrecy

1030.10 Official Information Act 1982
The Official Information Act 1982 applies to information which is held by Inland Revenue. It does not overrule the secrecy provisions of the Tax Administration Act 1994. Any information relating to the personal affairs or identity of a particular taxpayer remains confidential to that taxpayer or the properly authorised agent. The Act does not substantially change the information that Inland Revenue already makes available, but it does enable taxpayers and other interested parties to obtain additional information in relation to technical rulings that had not previously been made available. The following information may be available on request.

1) Personal information
Information held relating to the affairs of an identifiable taxpayer (individual, company, etc) is available to that person. The types of information held that can be given include:
(a) Details from the tax return and assessments;
(b) Details of the correspondence held;
(c) Details of interview notes;
(d) Copies of the ledger record.

2) Official information
The types of information held that can be given include:
(a) Details of Inland Revenue rulings on technical matters;
(b) Details of Inland Revenue policy and practice.

These matters are included in Inland Revenue manuals available for perusal at the public counter in each Inland Revenue district office.

3) Protected information
The Official Information Act 1982 protects from disclosure certain kinds of information that have been obtained by or are in the possession of Inland Revenue in relation to the detection of offences that may have occurred against the Inland Revenue Acts. Inland Revenue does not propose to release such information. Examples of this type of information are:
(a) Reports on income tax inspections or investigations;
(b) Advice on transactions or activities given to Inland Revenue in confidence;
(c) Procedure sheets outlining methods to detect evasion;
(d) Procedures to check the authenticity of claims made in the annual returns.

Instances also arise where a particular question or issue is the subject of a legal opinion given by a legal officer of Inland Revenue. Any such opinion is privileged and disclosure will not be granted. Requests for information are required to be specific and to provide sufficient detail to enable the subject matter to be correctly identified. If needed by a taxpayer, assistance to meet this requirement will be provided by staff in the local district office. Written requests for information should be addressed to the CIR at the office where the taxpayer’s records are retained. However, verbal requests can be made.
In *TRA Case F118* (1984) 6 NZTC 60,130, a taxpayer company in business as tax advisers was issued with amended assessments to which it objected by way of case stated. The taxpayer sought information from Inland Revenue under the Official Information Act as to Inland Revenue’s basis for disallowing the objection. It was held that taxpayers are not entitled to know factual reasons for Inland Revenue’s assessments. However, evidence relied on, or paper or documents in the possession of Inland Revenue, may be subject to an order for discovery.

**1030.15 CIR’s policy on releasing information**

The CIR’s policy on the release of information under the Official Information Act 1982 and the Privacy Act 1993 is set out in standard practice statement IR-SPS GNL 170 [see TIB vol 13:9 (September 2001) at 90-94]. The statement applies from 11 September 2001. The statement also explains the relationship of those Acts with the TAA and how the secrecy provisions in the TAA and the Child Support Act 1991 will be applied. For further details of the policy, refer to the statement.

Requests for information can be made orally or in writing. However, Inland Revenue may ask the requester to submit a request in writing to reduce any opportunity for misunderstanding. Requests for official information are required to be “specified with due particularity”. This means that Inland Revenue must be able to identify the information being sought. If a request is so general in nature that it is impossible to identify the information sought, Inland Revenue will ask the requester to be more specific. The fact that a request is for a large amount of information does not in itself mean that the request lacks due particularity.

If a natural person requests all personal information held about them, Inland Revenue will seek clarification as to whether the requester wants copies of material that has already passed between the requester and Inland Revenue (filed returns, correspondence, etc).

Inland Revenue is required to provide reasonable assistance to persons requesting information. Where the requested information is not held by Inland Revenue, but Inland Revenue believes it to be held by another Government agency or Minister, Inland Revenue is required to transfer the request within 10 working days.

In all cases information will be released upon request unless there are good reasons to withhold that information under either the Official Information Act 1982 or the Privacy Act 1993.

Where the information requested is contained in a document and there is good reason for withholding some of the information in that document, a copy of the document will be provided with the withheld information deleted.

Requests by natural persons for information about themselves are governed by the Privacy Act 1993. Under that Act, individuals have a right of access to information about themselves, subject only to the reasons for refusing access stipulated in the Act. These reasons are specified in the standard practice statement.

All other requests for information are governed by the Official Information Act 1982. These include:

(a) Requests for information, including personal information by natural persons about natural persons other than themselves;

(b) Requests for Inland Revenue’s internal rules or reasons for decisions;

(c) Requests by bodies corporate for information about themselves.

Under the Official Information Act 1982, there are different reasons for refusing information requests depending on which part of the Act the request is made under. These reasons are specified in the standard practice statement [see 1030.10].

Inland Revenue is required by statute to make a decision on a request as soon as reasonably practicable and no later than 20 working days after the receipt of the request. Any request for the release of information will be dealt with as a matter of urgency.

When Inland Revenue is unable to respond within 20 working days, it will write to the requester advising the extended time-frame. Inland Revenue may be unable to action a request within 20 days if it involves a large quantity of information and meeting the original time limit would unreasonably interfere with the operations of Inland Revenue, or if consultation is necessary in order to make a decision on the request. If
the requester is dissatisfied with the extension of time, they can seek a review by the Ombudsman or the Privacy Commissioner.

A response by Inland Revenue to a request made under the Official Information Act 1982 or the Privacy Act 1993 will include:

(a) A repeat of the original request;
(b) A reference to the Act the request has been considered under;
(c) Inland Revenue’s decision on the request;
(d) The reason for refusal, if Inland Revenue has refused the request in whole or in part;
(e) The requester’s right to seek an investigation and review by the Ombudsmen or Privacy Commissioner of the decision, or have the decision reviewed by a review officer who reports directly to the CIR in case of a refusal.

Under the Official Information Act 1982, Inland Revenue may charge for the provision of information if considerable departmental resources are needed to satisfy the request. If Inland Revenue intends to charge for providing information, an interim letter will be issued detailing the proposed charge and whether whole or part payment is required before the information will be released. It is Inland Revenue policy not to impose charges on Members of Parliament and parliamentary research units. Inland Revenue will also not charge a natural person for the supply of personal information about that person.

Neither the Privacy Act nor the Official Information Act restricts the effect of the secrecy obligations imposed on Inland Revenue staff by the TAA [see 1030.20].

When a request is to be considered under the TAA, Inland Revenue will consider the intent of the Official Information Act 1982 and/or the Privacy Act 1993. For example, personal information about a requester may not be given to the requester:

(a) Once Inland Revenue has advised that a tax investigation is to commence and disclosure would prejudice the effective conduct of the investigation;
(b) When the information requested would disclose the identity of a person who has supplied information to Inland Revenue, thereby breaching an obligation of confidentiality;
(c) When the information requested would disclose particular targeting or investigation techniques and selection criteria which, if disclosed, would prejudice Inland Revenue’s ability to investigate in the future.

In these cases, a request may be refused as the release of this information would be likely to prejudice the maintenance of the law.

1030.20 Officers of Inland Revenue to maintain secrecy [TAA, s 81]

(1) Requirement to maintain secrecy [TAA, s 81(1), (1C)] [TAA, s 81]

Inland Revenue officers are required to maintain, and to assist in maintaining, the secrecy of all matters relating to the following legislation:

(a) The Inland Revenue Acts, or another Act that is or was administered by Inland Revenue;
(b) The Accident Compensation Act 2001, the Accident Insurance Act 1998, the Accident Rehabilitation and Compensation Insurance Act 1992, or the Accident Compensation Act 1982;
(c) The New Zealand Superannuation Act 1974;
(d) Any Act that imposes taxes or duties payable to the Crown.

Inland Revenue officers must not communicate any of these matters, except for the purpose of carrying into effect the legislation listed above.

Before an Inland Revenue officer performs their first official duty as an officer, they must make a declaration of secrecy and fidelity in the form prescribed by the CIR. The declaration must be made before the CIR, an
officer of Inland Revenue, or a person authorised by or under the Oaths and Declarations Act 1957 to take statutory declarations.

(2) When communication allowed [TAA, s 81(1B)]

An Inland Revenue officer may communicate a matter if:

(a) The communication is for the purpose of executing or performing a duty of the CIR, or for the purpose of supporting the execution or performance of such duty; and

(b) The CIR considers that such communication is reasonable with regard to the relevant purpose described in (a), and with regard to the following:

(i) The CIR’s obligation at all times to use best endeavours to protect the integrity of the tax system;

(ii) The importance of promoting compliance by taxpayers, especially voluntary compliance;

(iii) Any personal or commercial impact of the communication;

(iv) The resources available to the CIR; and

(v) The public availability of the information.

IRD has issued a standard practice statement on how it will apply its discretion to release secret information under the exception in TAA, s 81(1B). The statement outlines the factors that IRD must take into account and the process it will follow to ensure that the discretion is exercised correctly, and that there is a consistent approach taken by IRD staff when exercising the discretion. See SPS 11/07, TIB Vol 24:1 (February 2012) at 3 to 15.

(3) Divulging information to a Court [TAA, s 81(3)]

An Inland Revenue officer is not required to produce in a Court or tribunal any document, or to divulge or communicate to any Court or tribunal any matter or thing, coming under the officer’s notice in the performance of the officer’s duties as an officer of Inland Revenue, except when it is necessary to do so for the purpose of:

(a) Carrying into effect

(i) The Inland Revenue Acts, including all Acts, whether repealed or not, at any time administered by Inland Revenue;

(ii) The Accident Compensation Act 1982, the Accident Rehabilitation and Compensation Insurance Act 1992, the Accident Insurance Act 1998, or the Accident Compensation Act 2001; or

(iii) Any other enactment imposing taxes or duties payable to the Crown;

(b) Carrying into effect the powers, duties and functions of the CIR under the New Zealand Superannuation Act 1974.

The effect of s 81(3) was confirmed in Hester v Commissioner of Inland Revenue (2003) 21 NZTC 18,182 (HC), in which the High Court refused to order the CIR to answer questions which, if answered, could potentially have identified information on other taxpayers. In this case the plaintiffs, who were the trustees of a church superannuation scheme, were seeking information from the CIR on the tax treatment of superannuation schemes run by other religious organisations.

The meaning of “for the purpose of carrying into effect” the Inland Revenue Acts was clarified in Knight v Barnett (1991) 13 NZTC 8,014 (CA). The appellants brought a civil action against Inland Revenue for damages and sought an order requiring Inland Revenue to produce certain documents required as evidence. Inland Revenue refused on the grounds that s 13(3) of the Inland Revenue Department Act 1974 (the precursor to s 81(3) of the TAA), gave privilege against disclosure because the information was not necessary for the carrying into effect of the Inland Revenue Acts. The Court of Appeal held, in a majority decision, that the carrying into effect of the Inland Revenue Acts includes their proper implementation and administration. Where the CIR is a party to litigation, whether as claimant or defendant, such activity is the carrying into
effect or implementation or administration of the Inland Revenue Acts. As a result, Inland Revenue was required to produce the documents.

In *R v Morris* [2005] 2 NZLR 684, (2005) 22 NZTC 19,217 (CA), the Court of Appeal was required to determine whether the provisions of ss 81(1) and 81(3) of the TAA applied to a tax prosecution brought under the Crimes Act 1961. Mr Morris was charged under the Crimes Act with using IR3 income tax returns with intent to defraud. He objected to evidence being given by an Inland Revenue officer on the ground that it would contravene the secrecy provisions of s 81 of the TAA. The Court of Appeal held that, provided the Inland Revenue officer’s proposed evidence was admissible under the general law, the Inland Revenue officer was not prevented by s 81(1) from giving evidence, because the purpose in giving the evidence was to carry into effect an Inland Revenue Act (namely, the TAA 1994). The Court further ruled that s 81(3) of the TAA was not relevant in this case because that subsection only applies when the CIR or an Inland Revenue officer seeks to invoke privilege.

**4) Specific situations in which information may be divulged [TAA, s 81(4)]**

The CIR is authorised to communicate or divulge information in specific, defined circumstances, mainly to other Government agencies. There are too many to list them all in this publication, but some examples are set out below.

Under s 81(4)(d) of the TAA the CIR can provide information to an employee of the Department of Statistics if that officer is authorised to receive the information and the CIR considers that it is “reasonably necessary” and “not undesirable” to disclose such information.

The CIR is authorised under s 81(4)(fb) of the TAA to communicate information to the Charities Commission that the Commission is authorised to receive and which the CIR considers is not undesirable to disclose. The information must be reasonably necessary to enable the Commission to carry out its duties as lawfully conferred by the Charities Act 2005.

Under s 81(4)(q) of the TAA the CIR is authorised to communicate information for the purposes of administering s 85H of the TAA, which relates to paid parental leave.

Under s 81(4)(r) of the TAA the CIR may communicate information to the FMA, where that information is reasonably necessary to enable the FMA to perform its duties or functions in relation to the KiwiSaver scheme, and the CIR considers that it is not undesirable to disclose that information.

Staff of WINZ, ACC, and the Department for Courts, and any other persons who have access to restricted information, are bound by secrecy provisions similar to those imposed on Inland Revenue staff [TAA, ss 86, 87].

Breaches of the secrecy provisions may be punishable with imprisonment or fines [TAA, ss 143C to 143E].

**1030.25 Authorised disclosure [TAA, ss 82 to 85I]**

Inland Revenue is authorised to disclose taxpayer information to the following organisations and for the following purposes:

(a) ACC and WINZ, for matching purposes [TAA, s 82]:

(i) To verify the entitlement to, or amount of, a benefit or earnings-related compensation;

(ii) To verify whether any premium or levy is payable and the amount of the premium or levy.

(b) WINZ [TAA, ss 82A, 83, 84, 85]:

(i) To ensure the correct tax file numbers of beneficiaries are supplied, to prevent cessation of benefit payments;

(ii) To enable the issue of social welfare entitlement cards;

(iii) To verify entitlement to, or eligibility for, an entitlement card;

(iv) To identify qualifying persons and their spouses who are in receipt of WFF tax credits from both Inland Revenue and WINZ;

(v) To verify entitlement of a qualifying person to any benefit;
(vi) To assist WINZ to recover money owed by debtors.
Inland Revenue is allowed to supply the Ministry of Justice with information relating to persons who have defaulted in the payment of fines [TAA, s 85A]. The information which can be supplied includes:
(a) The last known address of the defaulter;
(b) The last known telephone number of the defaulter;
(c) The name of the last known employer of the defaulter;
(d) The address of the last known employer of the defaulter; and
(e) The telephone number of the last known employer of the defaulter.

The date when the information was most recently updated must also be supplied.
Inland Revenue and WINZ are allowed to exchange information in order to provide assistance to the government of a country with which New Zealand has a social security agreement [TAA, ss 85B, 85C]. WINZ is authorized to supply specified personal information supplied to it by Inland Revenue to the competent institution of a foreign government. Inland Revenue may supply information to ACC to enable ACC to assess levies for employers, self-employed persons, private domestic workers and shareholder-employees [TAA, s 85E].

Inland Revenue is permitted to provide certain information to the New Zealand Film Commission to enable the Commission to determine the entitlement of a company to a government screen production payment [see 460.15; TAA, s 85F].

Inland Revenue is authorized to receive information from the Ministry for Social Development to enable Inland Revenue to:
(a) Commence paying family tax credit payments to a qualifying person who has ceased to be entitled to a WFF tax credit;
(b) Contact a person to invite them to apply for WWF tax credits, or to request additional information so that Inland Revenue can calculate a credit; or
(c) Withdraw or replace a certificate of entitlement [TAA, s 85G].

The CIR is permitted to compare taxpayer information with information provided by an applicant for paid parental leave, in order to identify persons who may be ineligible for paid parental leave or who may have received an overpayment. When these checks reveal a possible discrepancy, the CIR can communicate taxpayer information to the Department of Labour [TAA, s 85H].

The CIR is permitted to compare taxpayer information with information provided by an applicant for paid parental leave, in order to identify persons who have applied for both paid parental leave and a parental tax credit [see 420.40] for the same child. When a person has applied for both payments, the CIR can decline one of the payments [TAA, s 85I].

Inland Revenue has the authority, which overrides all secrecy obligations in all enactments, to disclose information required to be disclosed under a double tax agreement or tax recovery agreement to an authorised person in another territory [TAA, s 88].
Partnerships

Chapter 1050

Partnerships

1050.05 What is a partnership? [s YA 1]

For tax purposes, “partnership” means a group of two or more persons who have, between them, the relationship described in s 4(1) of the Partnership Act 1908. It also means a joint venture, if the joint venturers all choose to be treated as a partnership for the purposes of the ITA 2007 and the TAA 1994. Co-owners of property (other than those who are merely co-shareholders or co-trustees) can also be treated as a partnership for tax purposes provided that all of the co-owners elect to be treated that way.

“Partnership” also includes a limited partnership. A limited partnership is a limited partnership registered under the Limited Partnerships Act 2008 and includes an overseas limited partnership. It does not include a listed limited partnership or a foreign corporate limited partnership. These two types of entity are treated as companies for tax purposes.

A “New Zealand partnership” is a:

(a) Limited partnership registered under the Limited Partnerships Act 2008;

(b) Partnership that has 50 per cent or more of its partners’ interests in capital, by value, held by New Zealand residents; or

(c) Partnership that has its centre of management in New Zealand.

A “small partnership” is a partnership that is not a limited partnership and which has five or fewer partners, none of whom are companies or other partnerships.

A “partner” in relation to a partnership means a person who is a member of the partnership. It includes both a limited partner of a limited partnership and a general partner of a limited partnership. It also includes a joint
venturer or co-owner where an election has been made for that entity to be treated as a partnership for tax purposes.

1050.10 Partnership evidence

A written partnership agreement is not essential and the existence of a partnership can be determined from a consideration of all of the surrounding circumstances: *Morden Rigg and Co v Monks* (1923) 8 TC 450. However, the matters concerning genuine partnership agreements which need to be in written form are highly important [see 1050.30]. The distinction between a joint venture agreement and a partnership is often difficult: *Harley v Commissioner of Inland Revenue* [1971] NZLR 482 (CA).

1050.15 Joint tax return required

When two or more people carry on business through a joint venture (as opposed to a partnership), each person is required to return their income and deductions separately and file a separate return of income. The one exclusion from this rule is an “airport operator” [s HG 1]. However, different rules apply to partnerships.

For tax purposes, under s HG 2, each partner in a partnership is treated as:

(a) Carrying on the activity carried on by the partnership;
(b) Holding the partnership’s property in proportion to the share in the partnership;
(c) Being party to every arrangement to which the partnership is a party, again in proportion to each partner’s share in the partnership; and
(d) Doing, and being entitled to do, everything that the partnership does or is entitled to do.

**TaxNote:** A joint venture can be treated as a partnership where all joint venturers choose this option [see definition of “partnership” in 1050.05].

Income, gains, expenditure, losses and tax credits are accumulated in the partnership. Each partner’s share of each of those things is then calculated by applying the particular partner’s “partnership share”. Each partner’s share of income from any particular source, whether it be assessable, exempt or excluded income, or deductions, losses, or tax credits, retains its nature and flows through to the partners’ individual returns on that basis. The partnership share of each partner will generally be set out in the partnership agreement.

This treatment does not apply to any of the following:

(a) Expenditure or loss that results from a new partner acquiring a share in the partnership from another partner;
(b) Supplementary dividends to the extent that subpart LP applies [see 1010 NON-RESIDENT INVESTORS];
(c) Imputation credits to the extent that s LE 6 applies [see 670 IMPUTATION].

It is not necessary that the partner be a partner at the time at which an amount of expenditure or loss was incurred [s HG 2(3), see 1050.27].

Partnerships are required to make a joint return setting out the total amount of income derived by the partners in the partnership, each partner’s share in the income and a summary of the deductions of each partner. There is no joint assessment. Each partner is separately assessed.

1050.20 Husband and wife partnerships

It is not necessary for a husband and wife to have a written deed of partnership in order to be held to be carrying on business as partners. The determination of whether a husband and wife are carrying on a business as partners is based on the facts of each case. Contributions by way of capital introduced and services performed may, therefore, be particularly relevant. However, the matters concerning genuine partnership agreements needing to be in written form must be taken into account.

The position of Dutch immigrants, who were married in the Netherlands and to whom the Dutch law of “community of property” applies, has been considered. It appears that only on the termination of the marriage,
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or in the event of a dispute between the parties, are they deemed to own the marital assets on a 50/50 basis. The consequence is that the liability to New Zealand income tax of such people remains unaffected, namely:

(a) Income from the personal exertion of one spouse [see 960.10] is treated as being derived by that spouse alone;
(b) Income from assets owned in the name of one spouse is derived by that spouse alone; and
(c) Income from assets owned in the names of both spouses is derived in the same proportion as the ownership of the assets.

1050.25 Relatives in partnerships [ss GB 23, GB 24]

Family partnerships, eg between husband and wife or between parents and children, can be a convenient means of reducing tax liability. However, where the amount of remuneration paid to a relative or share of profit allocated to one of the partners is excessive having regard to the contributions by way of services, capital, or otherwise, the profits or losses of the partnership may be reallocated for taxation purposes between the partners. See 70 ASSOCIATED PERSONS AND RELATIVES for the definition of the term “relative”.

In *TRA Case S2 (1995)* 17 NZTC 7,012, a husband and wife contributed $8,000 and $2,000 respectively towards the purchase of a rental property. The property was sold and another rental property purchased with the sale proceeds. The husband and wife owned both properties as joint tenants and outgoings on the properties were met from matrimonial money. The husband was responsible for managing the properties. There was no written partnership agreement. The 1987 accounts were prepared for a partnership between the husband and wife, and losses were allocated on a 50/50 basis. However, from 1988 to 1992 the accounts allocated all rental losses to the husband. The CIR reassessed the losses and allocated them for the 1989-1992 years on a 50/50 basis under s GD 3 of the ITA 2004 [now s GB 23]. The TRA held that the husband and wife were partners carrying on a rental property business or income earning process. In the absence of a written agreement to the contrary, the losses must be shared equally. The TRA rejected the submission by the taxpayers that the rental losses should be allocated on the basis of the original contributions. This decision was based on:

(a) The further contributions from relationship property towards the mortgage and other outgoings.
(b) Joint liability of the parties under the mortgage.
(c) The fact that both were ratepayers and on the Valuation New Zealand roll.
(d) The muddlement in the presentation of their accounts.
(e) The fact that the 100 per cent allocation of losses to the husband could be viewed as self-serving from a taxation point of view.

Section GB 23 applies to partnerships when:

(a) A partnership carries on business, and two of the partners are relatives; or if a partner is a company, a director or shareholder of the company is a relative of any partner.
(b) A company carries on business in partnership with a relative of a director or shareholder of the company.

The CIR may reallocate the share of profits or other income payable to or for the benefit of, or reallocate the share of losses borne by, the relative or company if the CIR considers that the allocation is unreasonable. To determine whether an allocation is reasonable, the CIR must have regard to all of the following:

(a) The nature and extent of the services rendered;
(b) The value of the contributions made by the respective partners by way of services, capital, or otherwise; and
(c) Any other relevant matters.

If the CIR then forms the opinion that the amount of income or losses allocated to a relative is not reasonable, the CIR may reallocate the profits, income, or losses (before the deduction of any amount payable to the relative) between the partners in such shares as the CIR considers reasonable. The CIR cannot reallocate

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income or losses if a genuine partnership contract exists [see 1050.30]. This is an anti-avoidance provision aimed at arrangements which allocate income or loss based on tax advantages, rather than on contributions to the partnership. The CIR considers the following information (when evaluating the allocation of partnership profit, income, or loss):
(a) *The services rendered by each partner*: Relevant factors include the duties and responsibilities of each partner, time spent on partnership business, and any special skills or expertise of the partners.
(b) *Capital contributions*: Usually capital contributions are shown in the partnership accounts and this information is relied on. The CIR may require more information if a partner has made assets available to the partnership and is not receiving rent or lease payments.
(c) *Other relevant matters*: These may include any special circumstances of the partnership business.

**1050.27 Partners entering and exiting a partnership** [ss HG 4, HG 5, HG 6, HG 7, HG 8, HG 9]

From 1 April 2008, subpart HG sets out the tax treatment that applies when:
(a) A partnership is dissolved;
(b) An existing partner leaves a partnership; or
(c) A new partner enters an existing partnership.

(1) *Partnership is dissolved* [s HG 4]

A partnership can be dissolved by agreement of the partners, by way of a Court order, or under a relevant provision of the partnership agreement. The tax effect of the dissolution of a partnership occurs immediately before the partnership is actually dissolved.

From 1 April 2008, new rules apply where a partnership (other than a limited partnership) is to be finally dissolved and the partnership business will not continue being carried on in partnership. For tax purposes, each partner is treated as having disposed of all of that partner’s interests in the partnership at market value and to a single third party immediately before the dissolution and reacquiring it for the same value immediately after the dissolution. The normal tax consequences flow from this deemed disposal. Any consideration actually received by the partner from any party in relation to the final dissolution of the partnership is ignored for tax purposes.

This treatment does not apply:

(a) To the extent to which a partner disposes of their partnership interests to a non-associated person. When determining whether or not two persons are associated for the purposes of this provision, the partner’s partnership capacity is ignored; or

(b) Where the following conditions are met:

(i) Immediately before the dissolution there are only two partners and they are each the spouse of the other;

(ii) The dissolution is caused by the death of one of the partners or the settlement of relationship property;

(iii) The interest on one of the partners is transferred to the other partner (ignoring any intermediate transfer to an executor or administrator); and

(iv) the transfer of those interests is subject to subparts FB or FC treat the transfers as disposals for other than market value. Subparts FB and FC relate to relationship property [see 960 MATRIMONIAL AND RELATIONSHIP PROPERTY] and gifts.

The exemption for partnerships consisting of two people each of whom is the spouse of the other ensures that neither the death of one spouse nor a relationship property split results in the crystallisation of the tax effect of a deemed disposal and reacquisition at market value. Where the deemed treatment outlined above does not apply, the normal rules apply to the disposal of each partner’s interest in the partnership assets.
Partners entering and exiting the partnership

From a legal perspective, when a partner leaves a partnership or a new partner joins, the old partnership is dissolved and a new partnership is formed. This has caused tax problems, particularly for larger professional partnerships where changes in partners is not uncommon event. The new rules set out below address these difficulties. The following rules do not apply where the partnership is totally dissolved as outlined above.

Partners entering and exiting the partnership — $50,000 rule [s HG 5]

When a partner disposes of some or all of their “partner’s interests” to a new or existing partner (called an “entering partner”), the following formula must be applied:

\[ \text{disposal payment} + \text{previous payments} - (\text{gross tax value} - \text{liabilities}) - 50,000 \]

Where:

- “Disposal payment” is the total amount of consideration paid or payable to the exiting partner for the current interests.
- “Previous payments” is the total amount of consideration paid or payable to the exiting partner for other disposals of some or all of their partner’s interests that have occurred in the year before the disposal of the “current interests”. In the definition of “gross tax value” (below) this is called the “other interests”.
- “Gross tax value” is the total of:
  (a) The value of the “current interests” and the “other interests” at the time at which the relevant interest is disposed of to the extent to which those interests consist of revenue account property, depreciable property or financial arrangements; and
  (b) The market value of the “current interests” and the “other interests” at the time at which the relevant interest is disposed of to the extent to which those interests consist of consist of anything else.
- “Liabilities” is the amount of liabilities under “generally accepted accounting practice” (GAAP) at the time at which the relevant interest is disposed of, calculated by reference to the exiting partner’s partnership share for the relevant interest.

If the amount calculated under the formula is less than zero:

(a) The “disposal payment” is excluded income of the exiting partner;
(b) The entering partner (or partners) to whom the partnership interest is sold is denied any deduction for the “disposal payment”; and
(c) For the purposes of calculating the income and deductions of an entering partner for the part of the income year after the disposal of the interests occurs and later income years, the entering partner steps into the shoes of the exiting partner. This means that, from that point onwards, the entering partner is treated as if they had acquired the current interests when the exiting partner acquired them and held them to that point in time; and
(d) The exiting partner is denied any deduction in relation to the current interests for the income year in which the disposal of the interests occurs and later income years to the extent to which the entering partner is allowed the deduction in item (c) above.

Partners entering and exiting the partnership — trading stock [s HG 6]

To the extent to which a disposal of a partner’s interest in a partnership include trading stock (but not livestock) the following treatment applies where, for the income year of disposal, the total turnover of the partnership is $3,000,000 or less:

(a) The amount of consideration paid or payable to the exiting partner for the trading stock is excluded income of the exiting partner;
(b) The entering partner is denied any deduction for the amount of consideration paid or payable to the exiting partner for the trading stock;
(c) For the purposes of calculating the income tax liability of an entering partner, the entering partner steps into the shoes of the exiting partner and is treated as if they had acquired and held the trading stock, not the exiting partner; and
(d) The exiting partner is denied any deduction in relation to the trading stock for the income year in which the disposal of the trading stock occurs and later income years, to the extent to which the entering partner is allowed a deduction under item (c) above.

(5) Partners entering and exiting the partnership — depreciable property [s HG 7]

To the extent to which a disposal of a partner’s interest in a partnership includes an item of depreciable property (but not depreciable intangible property), the following treatment applies if the total cost of the item when it was first acquired by the partnership is $200,000 or less:

(a) The amount of consideration paid or payable to the exiting partner for the depreciable property is excluded income of the exiting partner;

(b) The entering partner is denied any deduction for the amount of consideration paid or payable to the exiting partner for the depreciable property;

(c) For the purposes of calculating the income tax liability of an entering partner for the part of the income year after the disposal of the depreciable property occurs and later income years, the entering partner steps into the shoes of the exiting partner. The means that the entering partner is treated as if they had acquired the depreciable property when the exiting partner acquired it and held it to that point in time;

(d) The exiting partner is denied any deduction in relation to the depreciable property for the income year in which the disposal of the depreciable property occurs and later income years, to the extent to which the entering partner is allowed a deduction under item (c) above.

(6) Partners entering and exiting the partnership — financial arrangements and some excepted financial arrangements [s HG 8]

To the extent to which a disposal of a partner’s interest in a partnership include a financial arrangement or an excepted financial arrangement that is in New Zealand currency; interest-free, and repayable on demand, and where the following two conditions are met:

(a) the purpose for which the financial arrangement or excepted financial arrangement was entered into was necessary and incidental to the business of the partnership; and

(b) the partnership does not derive income from a business of holding financial arrangements, the following treatment applies:

(a) The amount of consideration paid or payable to the exiting partner for the financial arrangement or excepted financial arrangement is excluded income of the exiting partner;

(b) The exiting partner is not required to calculate a base price adjustment;

(c) The exiting partner is denied any deduction in relation to the financial arrangement or excepted financial arrangement for the income year in which the disposal of the financial arrangement or excepted financial arrangement occurs and later income years;

(d) The entering partner is denied any deduction for the amount of consideration paid or payable to the exiting partner for the financial arrangement or excepted financial arrangement;

(e) For the purposes of calculating the income tax liability of an entering partner for the part of the income year after the disposal of the financial arrangement or excepted financial arrangement occurs and later income years, the entering partner steps into the shoes of the exiting partner. This means that the entering partner is treated as if they had acquired the financial arrangement when the exiting partner acquired it and held it to that point of time.

(7) Partners entering and exiting the partnership — short term agreements for the sale and purchase [s HG 9]

To the extent to which a disposal of a partner’s interest in a partnership include a short-term agreement for the sale and purchase (eg trade receivables) the following treatment applies:
Partnerships

(a) The amount of consideration paid or payable to the exiting partner for the short-term agreement for the sale and purchase (the agreement) is excluded income of the exiting partner;

(b) The entering partner is denied any deduction for the amount of consideration paid or payable to the exiting partner for the agreement;

(c) For the purposes of calculating the income tax liability of the entering partner for the part of the income year after the disposal of the agreement occurs and later income years, the entering partner steps into the shoes of the exiting partner. This means that the entering partner is treated as if they had acquired the arrangement when the exiting partner acquired it and had held it to that point in time;

(d) The exiting partner is denied any deduction in relation to the agreement to the extent to which the entering partner is allowed a deduction under item (c) above.

(8) Small partnerships [s HG 3(2)]

A “small partnership” is defined as being a partnership that is not a limited partnership and has five or fewer partners, none of whom are companies or partnerships.

The partners in a small partnership can elect not to apply the above treatment. The election is made by the entering partner, the exiting partner and the partnership furnishing returns of income that ignore the treatment. These new criteria apply for income years commencing from 1 April 2008.

(9) Partners entering and exiting the partnership — livestock [ss HG 10, EC 26B]

Partners in a small partnership can elect that the general provisions do not apply to the transfer of partnership interests that consist of certain types of livestock where those interests are transferred to an entering partner. The election is made by way of the exiting partner, the entering partner and the partnership filing returns of income that reflect the election.

The election can be made only in respect of livestock that meets all of the following criteria:

(a) It is specified livestock;

(b) It is female breeding stock; and

(c) For that income year, the partners use national standard cost or the cost price method for valuing livestock.

For the purposes of calculating the income tax liability of an entering partner for the income year in which the disposal livestock occurs and later income years, the entering partner can elect to step into the shoes of the exiting partner. Where the election is made, the entering partner is treated as if they had acquired the livestock when the exiting partner acquired it and held it to that point in time. At the end of the income year, the entering partner is required to add to the existing cost base, the amount calculated under the following formula:

\[
\frac{\text{Livestock cost base difference} - \text{Current year count}}{\text{Allowed years}}
\]

Where:

“Livestock cost base difference” is the cost base that the entering partner would have for the specified livestock at the end of the income year in which they were acquired (under their normal livestock valuation methodology) reduced by the exiting partner’s existing cost base for the specified livestock at the end of that year. It must be a positive number.

“Current year count” is the “allowed years” less the number of years between the current year and the year in which the specified livestock was acquired. Any year in which the partners do not use either the national standard cost method or the cost price method is excluded from the count. The “current year count” may equal the “allowed years” but must not be a negative number. For example, if the “allowed years” is four (see below), the income year of acquisition was 20X0-20X1 and the current income year is 20X3-20X4, the “current year count” is one. This is because there are three income years between 20X0-20X1 and 20X3-20X4 (X4 minus X1 = 3) and (4 minus 3 = 1).
“Allowed years” can be either four or five. It is four if the partners acquire or dispose of any partnership interests that include any livestock between the date on which the entering partner’s acquisition of the specified livestock and the end of the income year in which that entering partner’s livestock acquisition occurred. Otherwise it is five.

This spreading provision applies for the 2009-2010 and subsequent income years.

**1050.30 Conditions for genuine partnership contract [s GB 24]**

Section GB 23 does not apply to genuine contracts of employment or partnership. A genuine contract complies with the following conditions:

(a) It is in writing signed by all of the parties;
(b) All of the parties are over 20 years of age when the contract is signed;
(c) It is binding on all parties for not less than three years and cannot be dissolved before then, except for the reasons specified in ss 36 and 38 of the Partnership Act 1908;
(d) Each party to the contract has:
   (i) Real and effective control over their entitlement to the remuneration, salary, wages, share of profits, or other income under the contract; and
   (ii) Real and effective liability for the share of losses to be borne under the contract; and
(e) The remuneration or share of profits of the relative is not an amount that constitutes in whole or in part a gift for the purposes of the Estate and Gift Duties Act 1968.

Where a gift is present the partnership is not invalidated but is subject to adjustment for the respective shares of its members for taxation purposes.

There is no hard and fast rule for determining when a contract is, or is not, a “genuine contract”, but *Case 18 5 NZTBR* gives some guidance as to the principles involved. The case concerned a husband and wife operating a plumbing business in partnership under an agreement which provided for the first $2,000 of the profits to be paid to the husband and for the balance to be divided equally between the partners. For the year ended 31 March 1969 the net profit was $10,929.30, and this amount was allocated between the partners as follows:

<table>
<thead>
<tr>
<th></th>
<th>Husband</th>
<th>Wife</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of services (per week for 52 weeks)</td>
<td>$3,939.00</td>
<td>$172.86</td>
</tr>
<tr>
<td>Interest on capital</td>
<td>$172.86</td>
<td>$6% on opening capital $2,382</td>
</tr>
<tr>
<td>Management</td>
<td>10% of net profit</td>
<td>$1,092.90</td>
</tr>
<tr>
<td></td>
<td>$5,204.76</td>
<td>$428.92</td>
</tr>
</tbody>
</table>

The CIR was not satisfied with this allocation, and reallocated the profits on the following basis:

<table>
<thead>
<tr>
<th></th>
<th>Husband</th>
<th>Wife</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of services (per week for 52 weeks)</td>
<td>$3,939.00</td>
<td>$286.00</td>
</tr>
<tr>
<td>Interest on capital</td>
<td>$172.86</td>
<td>$2,382</td>
</tr>
<tr>
<td>Management</td>
<td>10% of net profit</td>
<td>$1,092.90</td>
</tr>
<tr>
<td></td>
<td>$5,204.76</td>
<td>$428.92</td>
</tr>
</tbody>
</table>

The CIR reallocation was as follows:

\[
\frac{$5,204.76}{$5,633.68} \times $10,929.30 = $10,097.20
\]

\[
\frac{$428.92}{$5,633.68} \times $10,929.30 = $823.10
\]

The husband worked 54 hours per week in the business and the wife worked five hours per week. The wife’s share of profits was rounded up to $1,000. The taxpayers objected and the case was referred to the Taxation Board of Review. It was claimed that the partnership was genuine because the wife bore half the housekeeping expenses and because the agreement provided that the parties were to share losses equally, but the Board
found that the wife was favoured by the division of profits to such an extent as to make part of those profits a gift and consequently the agreement was not genuine, and the CIR was entitled to reallocate the profits. However, the Board also found that certain adjustments should be made to the CIR’s calculations by allowing the husband $1.65 per hour for seven hours per week (54 less 47) spent on clerical work, and that interest on capital should be allowed at seven per cent, and that an allowance of 20 per cent should be made on each partner’s opening capital in consideration of the acceptance of liability for a half share of losses. On the making of these adjustments the allocation was amended to the following:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Husband</td>
<td>$9,545.85</td>
</tr>
<tr>
<td>Wife</td>
<td>$1,383.45</td>
</tr>
</tbody>
</table>

**1050.35 Factors used in determining whether a gift exists**

In determining whether a gift exists, the nature of contributions by each partner is considered. These contributions would generally be by way of capital contributions although, in some cases, a value may be placed on such things as skill, services, or perhaps connections.

The ratio of contributions by each partner compared with the ratio of partnership profit allocated to those same partners is considered. A bounty or gift may exist in a partnership where expert knowledge is an important factor and the relative’s contributions, in the absence of any specialised knowledge, are unrelated to the division of partnership profits.

An arm’s length test is applied to determine whether the taxpayer would have entered into a partnership with a stranger on the same terms including the share of profits.

Having determined inequality in a partnership which is not genuine, the CIR will reallocate partnership profits by placing values on the various contributions by each partner.

A partnership agreement may validly determine for tax purposes a partner’s share of a partnership loss on a basis other than capital contribution: *Reed v Young* [1986] 1 WLR 649 (HL).

**1050.40 Partner’s misappropriation of property [ss DB 43, CG 4]**

In calculating the net income derived by any partner, a deduction is allowed for any amount paid by that partner in discharging a legal liability to make good any loss suffered by any person (other than a partner or the spouse [see 960.10] of a partner). For the deduction to apply, the loss must result from misappropriation of property received in the course of the partnership business. The misappropriation must not have been committed by the partner or that partner’s spouse. The amount paid is allowed as a deduction for the income year during which it is paid. Any amount recouped by the partner (whether by way of insurance, indemnity, reimbursement, recovery, or otherwise) is deemed to be income derived by the partner in the year of receipt.

**Example:**

Hugh, Lou, and Doug carry on a computer repair business in partnership. Minnie brings her computer in for repair. Hugh sells the computer (without the knowledge of Lou or Doug) and keeps the proceeds. Hugh, Lou, and Doug reimburse Minnie for the loss of property. All of the partners are liable to make good the loss. Lou and Doug can deduct their part of the amount paid, in the year in which they make the payment. Hugh is not entitled to any deduction. Any amount that Lou and Doug later recover from Hugh is assessable income in the year in which they receive it.

In *TRA Case N7* (1991) 13 NZTC 3,048, (1990) 15 TRNZ 519, a partner could claim a deduction for defalcations which occurred during the course of the partnership. A deduction could not be claimed for trading debts.

See TIB vol 6:2 (August 1993) at 4, which states the CIR’s policy in situations when there is a partnership liability to make good a loss resulting from the misappropriation of property by a partner.

A deduction is allowed only if the partner is under a legal liability to make good the loss. It is not sufficient that the payment be made under a moral rather than a legal obligation.

Section 13 of the Partnership Act 1908 sets out the general principle by which partners are liable for any wrong committed by one of their partners. All partners are liable if a wrongful act or omission by any partner causes loss or injury to any person (except a partner in the firm) or incurs any penalty. The partners are liable
only if the wrong is caused by a partner acting in the ordinary course of the business of the firm or with the
authority of their co-partners.
Section 14 of the Partnership Act 1908 also holds the partnership liable for a loss in these two specific
situations:
(a) If a partner who is acting within the scope of his or her apparent authority receives a third person’s
money or property and misapplies it.
(b) If the partnership receives a third person’s money or property in the course of its business, and the
money or property is misapplied by one or more of the partners while it is in the partnership’s custody.
The CIR’s policy is that a taxpayer can claim a deduction for any amount paid to make good a loss that
another person suffers because of the misappropriation of property, provided that all of the following five
conditions are met:
(a) The taxpayer carries on business in partnership;
(b) The partnership or any of the partners receive property in the course of the partnership business;
(c) The owner of the property is not a partner in the partnership, or the spouse of one of the partners;
(d) Any partner except the taxpayer or his or her spouse misappropriates the property, causing a loss to
the property owner; and
(e) The taxpayer is legally liable to make good the loss.
**TaxNote:** It is not necessary for the taxpayer to make the payment directly to the property owner. Any
reimbursing payment made to an insurance office or indemnity fund that had previously made good the loss
is deductible.

### 1050.45 Rent paid by or to a partner

Rent payable by a partnership to one of the partners for property leased to the firm is deductible in full by
the firm (subject to the normal deductibility criteria) and assessable in full to the recipient. Similarly, rent
payable by a partner to the firm is deductible by the partner (subject to the normal deductibility criteria) and
constitutes part of the firm’s income.

### 1050.50 Interest on partner’s capital

Section 27 of the Partnership Act 1908 provides that:

“The interests of partners in the partnership property, and their rights and duties for the
partnership, shall be determined, subject to any agreement (express or implied) between
the partners, by the following rules: …

“(c) A partner making, for the purpose of the partnership, any actual payment or advance
beyond the amount of capital which he or she has agreed to subscribe is entitled to interest
at the rate of 5 percent per annum from the date of the payment or advance.

“(d) A partner is not entitled, before the ascertainment of profits, to interest on the capital
subscribed by him.”

The following passages in *Lindley on Partnership* (12th ed, Sweet & Maxwell, London, 1962), are relevant.  
At 357 (on the meaning of the capital of a partnership):

“The aggregate of the sums contributed by its members for the purpose of commencing or
carrying on the partnership business, and intended to be risked by them in that business.”

At 419 (on advances by a partner to a partnership):

“An advance by a partner to a firm is not treated as an increase of his capital, but rather as a loan
on which interest ought to be paid; and subject to any agreement between the partners, interest
is payable on money paid or advanced by one partner for partnership purposes beyond the amount
of capital which he has agreed to subscribe. The rate of interest given in such cases is simple
interest at 5 per cent but an agreement to pay a different rate may be inferred if a different rate
Partnerships

1050.55

is payable by the custom or the particular trade or has been charged and allowed in the books of
the particular partnership.”

Accordingly, in addition to genuine loans or advances made by a partner to the firm (other than partnership
capital subscribed), the amounts left in the firm out of the profits of each partner constitute payments or
advances beyond the amount of capital to which each agrees to subscribe. Accordingly, even if no provision
by agreement is made for interest, s 27 of the Partnership Act 1908 would itself have provided an entitlement
in this respect.

The significance of this is that, because the partner is legally entitled to the interest, the partnership is allowed
da deduction for it and the partner receiving the interest is assessable thereon as interest, not as part of the
partnership profits.

1050.55 Book debts acquired by partner

Where a partnership changes the mix of its partners, the old partnership is dissolved and a new partnership
is formed. On such occasions, book debts of the old partnership may be acquired by one or more of the
remaining original partners or one or more of the new partners. Where this occurs and any portion of such
debts subsequently proves to be bad and is written off, a deduction may be claimed only to the extent that
the partners owning the debts were also partners in the earlier partnership.

TaxNote: From 1 April 2008, this applies only where the partners have chosen not to apply the new rules
for changes in the make-up of partnerships [see 1050.27].

1050.60 Work in progress

After withdrawing from a partnership, any amount the partner receives which represents the proceeds from
uncharged work at the time of withdrawing from the partnership is assessable income and not a capital receipt:
Jamieson v Commissioner of Inland Revenue (1974) 1 NZTC 61,126 (CA).

TaxNote: From 1 April 2008, this applies only where the partners have chosen not to apply the new rules
for changes in the make-up of partnerships [see 1050.27].

1050.65 Salaries paid to a partner [ss DC 4, GB 23]

A deduction is available for payments made by a partnership to any partner for services performed under a
contract of service, provided the payment does not exceed the amount payable to the partner as specified in
the contract.

Bonuses payable to partners under a contract of service qualify for the deduction whether or not the amount
of the bonuses is specified in the contract of service.

The deduction is available only for amounts paid for services performed during the period commencing not
earlier than the date on which the contract becomes binding and ending on the date on which it terminates.

The partner must personally and actively perform the duties required under the contract. Those duties must
relate to the carrying on of the partnership business. The contract of service entered into by the working
partner must be in writing, signed by all partners, and must specify the conditions of employment and the
amount payable for services rendered. The payments are subject to s GB 23 where the working partner is a
relative of one of the partners.

The deduction is not available to a partnership which is engaged principally in the investment of money or
the holding of or dealing in shares, securities, investments, or interests in land.

Payments made to the working partner under these provisions are included within the definition of “salary
or wages”. PAYE must be deducted at source from all such payments. Fringe benefit tax does not apply to
any fringe benefits provided to the working partner.

When a salary is paid to a partner outside of these provisions, the salary is not a business expense and the
partnership cannot take it into account in determining its business profit or loss. However, the payment is
relevant to the allocation of profit or loss between the partners. The following example is taken from TIB
Partnerships

Example 1:
Joyce and Mike are partners. The partnership agreement provides for Mike to receive a salary of $40,000 per annum (which does not meet the requirements of s DC 4). The residual profits and losses, after taking into account Mike’s salary, are to be shared equally between Joyce and Mike.

<table>
<thead>
<tr>
<th>Profit before salary</th>
<th>$70,000</th>
<th>To be allocated for individual assessment.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary</td>
<td>$40,000</td>
<td>Not deductible from partnership income for tax purposes, but attributed to Mike</td>
</tr>
<tr>
<td>Profit after salary</td>
<td>$30,000</td>
<td></td>
</tr>
</tbody>
</table>

The partnership income is attributed $55,000 to Mike and $15,000 to Joyce. Mike’s share of the partnership income comprises the salary attribution of $40,000 and a half share of the balance — $15,000. Joyce’s share of the partnership income is $15,000, which is half of the balance after attributing Mike’s “salary”.

Example 2:
Joyce and Mike are partners. The partnership agreement provides for Mike to receive a salary of $40,000 pa (which does not meet the requirements of s DC 4). The residual profits and losses, after taking into account Mike’s salary, are to be shared equally between Joyce and Mike.

<table>
<thead>
<tr>
<th>Profit before salary</th>
<th>$20,000</th>
<th>To be allocated for individual assessment.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary</td>
<td>$40,000</td>
<td>Not deductible from partnership income for tax purposes, but attributed to Mike</td>
</tr>
<tr>
<td>Loss after salary</td>
<td>$20,000</td>
<td></td>
</tr>
</tbody>
</table>

The partnership income is fully attributed to Mike. This is because in terms of the partnership agreement he is entitled to the first $40,000 of partnership income. Mike has income from the partnership of $20,000 and Joyce has nil income from the partnership.

In TRA Case L28 (1989) 11 NZTC 1,172, a provision of a partnership deed was held to not comply with the provisions. A clause provided first that each partner would be paid interest on capital. Secondly, after providing for that interest and all other business outgoings, a salary would be paid “to each of the partners respectively commensurate with the time which each of them shall devote to the partnership business”. Thereafter loss or profit sharing was to occur.

1050.70 Special partnerships [ss HC 1, IE 1]

Special partnerships are a particular type of partnership governed by Part 2 of the Partnership Act 1908. There are two categories of partner in a special partnership. The first is the general partners. General partners are actively involved in the business and are jointly and severally liable for the debts of the partnership. General partners are treated in exactly the same way as partners in a normal partnership. The second category of partner is the special partners. Special partners’ liability is limited to their capital contributions. They are treated more like shareholders in a company than like partners in a partnership.

The Limited Partnerships Act 2008 has replaced the special partnerships provisions with a new regime for limited partnerships. Existing special partnerships can be reformed into limited partnerships, subject to transitional rules [see 1050.85]. For information on the taxation of special partnerships, see Staples Tax Guide 2008.

1050.75 Limited partnerships — overview

The Limited Partnerships Act 2008 introduces a new form of partnership which replaces the old special partnership regime.

(1) Key features

A limited partnership is a legal entity separate from its partners. It has two types of partner, being general partners and limited partners.

General partners manage the partnership. They are liable for the partnership’s debts and liabilities if the partnership is unable to honour them.
Limited partners have limited liability. Their liability is limited to the amount of their investment in the partnership. This limited liability can be lost where a limited partner takes part in the management of the partnership. However, the schedule to the Limited Partnerships Act does contain a list of activities that are deemed not to constitute management. These activities can be undertaken by a limited partner without loss of limited liability.

Limited partnerships and overseas constituted limited partnerships are required to register with the Registrar of Companies. However, unlike companies, the confidentiality of investors is maintained.

(2) Tax treatment

For income tax purposes, the income and gains, expenditure and losses, rebates and tax credits are allocated to the partners in proportion to each partner’s income share under the limited partnership.

For resident withholding tax purposes, it is the limited partnership that holds an exemption certificate, not the individual partners.

For GST purposes, limited partnerships registered under the Limited Partnerships Act 2008 are treated as companies.

1050.80 Limited partnerships — limitation on deductions [ss HG 11, HG 12]

The treatment of losses incurred by partners in a limited partnership is governed by s HG 11. A limitation applies to the following partners in a limited partnership:

(a) A limited partner;
(b) A general partner who was a limited partner of the limited partnership within the last 60 days of the income year; and
(c) A general partner who is or will be a limited partner within 60 days after the end of the income year.

These partners are denied a deduction to the extent to which their share of the deductions of the limited partnership exceed the amount calculated under the following formula below. The amount so calculated is called “the partner’s basis”. The formula is:

investments - distributions + income - deductions - disallowed amount

Where:

“Investments” is the total of:

(a) The market value of “capital contributions” (below), made by the partner to the limited partnership at the time at which the relevant contribution is contributed (or agreed to be contributed) by them;
(b) The amount paid by the partner for the assignment of capital contributions to them; and
(c) The secured amounts.

“Distributions” is the total of:

(a) The market value of distributions to the partner from the limited partnership; and
(b) The amount paid to the partner for the assignment of capital contributions by them.

“Income” is the total of:

(a) The partner’s share of partnership assessable income in that income year and all previous income years. This amount excludes dividends paid by a FIF for which the partner has FIF income, but only up to the amount of the partner’s FIF income for that income year;
(b) The partner’s share of realised capital gains in that income year and all previous income years, unless the gain is accounted for under item (a) above; and
(c) Assessable income that the partner has in previous income years from goods and services that they contributed to the limited partnership, if the income is not accounted for in items (a) or (b) above, or as “Investments” (above).

“Deductions” is the total of:
(a) The partner’s share of the partnership expenditure or loss in all previous income years, excluding any deductions denied in those previous years under this formula;
(b) The partner’s share of capital loss amounts in that income year and all previous income years, unless the loss is accounted for under paragraph (a); and
(c) The partner’s share of deductions that the partner is allowed in previous income years in relation to the assessable income item (c) of “Income” (above).

“Disallowed amounts” is the amount of “Investments” (above), made by the partner within 60 days of the end of the income year, if those investments are, or will be, distributed or reduced within 60 days following the end of the income year.

There is an exclusion to the limitation of deductions under this formula. The exclusion applies to exiting partners. The limitation does not prevent an exiting partner from obtaining a deduction up to the amount of net income that the exiting partner has for the amount received or receivable for the disposal of their partner’s interests.

(1) Definitions

“Capital contribution” includes a capital contribution for the purposes of the Limited Partnerships Act 2008.

“Limited partnership deduction” means, for the partner and the income year, the amount of any deductions that the partner would be allowed if the partner is treated as having no income or deductions other than those that arise from the limited partnership.

“Secured amounts” means, for the partner, the least of:
(a) The amount of the limited partnership’s debt that the partner or the “partner’s associate” (below) secures by a guarantee or indemnity;
(b) The amount that results from dividing the amount in item (a) by the number of partners who are jointly and severally liable for the debt;
(c) The amount that is the market value of property against which the guarantee or indemnity may be enforced, treating the partner’s interests as having a market value of zero; and
(d) the proportion of the amount described in item (c) above, that is attributable to the partner in the case of the partners being jointly and severally liable for the debt.

“Partner’s associate” means a person who is not a partner of the relevant limited partnership, and who is:
(a) a relative of the partner; or
(b) a company in the same wholly-owned group as the partner.

Section HG 12 provides that deductions denied to a partner under s HG 11 are carried forward to the following income year. Section HG 11 is then applied again at the end of the second income year and amounts denied as deductions are then carried forward to the third income year, and so on. However, carry-forward is denied where the limited partnership ceases to be a limited partnership in a later year to which the deductions are carried forward. Carry-forward is also denied where the partner ceases to be a partner in a later income year to which the deductions are carried forward, but are revived and claimable in a future income year in which the person again becomes a partner in the limited partnership.

1050.85 Limited partnerships — transitional rules for special partnerships [s HZ 3]

Transitional rules apply where a special partnership that exists as at 1 April 2008 is terminated and a limited partnership registered under the Limited Partnerships Act 2008 succeeds to that special partnership. The rules provide that no partner’s interests in the special partnership are treated as being disposed of merely because of that termination and succession. Further, the partners of the special partnership are treated as the same partners of the new limited partnership.
For the first income year, when the partners calculate their “partner’s basis” [see 1050.80], all of the partners are required to choose one of the two following methods for the calculation under the formula:

(a) They may choose to use the market value or the accounting book value (as at the last day of the income year) of the items described in the formula; or

(b) They may choose to apply the formula as if the special partnership had always been a limited partnership and all relevant rules relating to limited partnerships had always existed.

If the application of the formula then results in a “partner’s basis” of less than zero, the partner’s basis for that year is deemed to be zero.

1050.90 Limited partnerships — transitional rules for overseas limited partnerships [s HZ 4]

The transitional rules for overseas limited partnerships moving into the limited partnership rules is the same as that applying to special partnerships.

For the first income year, when the partners calculate their “partner’s basis” [see 1050.80], all of the partners are required to choose one of the two following methods for the calculation under the formula:

(a) They may choose to use the market value or the accounting book value (as at the last day of the income year) of the items described in the formula; or

(b) They may choose to apply the formula as if the special partnership had always been a limited partnership and all relevant rules relating to limited partnerships had always existed.

1050.95 Limited partnerships — anti-avoidance

Section GB 49 allows the CIR to substitute market value for the consideration under an arrangement entered into by a partner. This applies where the consideration under the arrangement is not market value and the purpose or effect of the arrangement is to defeat the intent and application of subpart HG.
Chapter 1070

Patents and Patent Rights

1070.10 Patent rights
“Patent rights” means the right to do or authorise anything that would, but for the right, be an infringement of a patent.

1070.20 Fees paid for patents [ss DB 36, DB 37]
The deductibility of expenditure incurred for the grant, maintenance, or extension of a patent is governed by the general permission in s DA 1. This means that, in order for a deduction to be available, the patent must be used in earning assessable income and the expenditure must not be capital in nature [see 230.10]. However, where a person who applies for the grant of a patent and is refused the grant or withdraws the application, s DB 37 provides relief. The person is allowed a deduction for expenditure incurred in relation to the application where that expenditure would have been part of the cost of fixed life intangible property if the application had been granted provided that expenditure is not deductible under another provision. The deduction is able to be taken in the income year in which the grant is refused or the application is withdrawn.

Expenditure incurred for the grant, maintenance, or extension of a patent which was acquired before 23 September 1997 is deductible under s DB 36 in the income year in which the expenditure is incurred provided that the patent is used in deriving assessable income for that year.

1070.30 Cost of devising patents [s DB 38]
Patents created or acquired on or after 1 April 1993 are able to be depreciated as “depreciable intangible property” under subpart EE [see 250.105]. Expenditure incurred on or after 1 April 1993 on the development of an intangible asset may be deductible under the research and development provisions of ss DB 33 and DB 34 [see 1240 RESEARCH AND DEVELOPMENT].

Where a patent has been granted for any invention, a deduction is allowed for any expenditure incurred by the taxpayer before 1 April 1993 in connection with the devising of the invention. The provision applies whether the person devised the invention alone or with another person. This deduction is allowable only to the inventor and then only where the invention is used by the inventor in deriving gross income. The CIR treats the receipt of royalties as “using the patent in deriving income”.

The costs of opposing an application by a competitor for the registration of a trade mark for a brand or article substantially similar to that already being marketed by the taxpayer is deductible, the expenditure being necessarily incurred to enable the taxpayer to carry on the business without interference: Commissioner of Inland Revenue v Murray Equipment Ltd [1966] NZLR 360 (SC). Costs of litigation proceedings for an alleged infringement of a trade mark or patent are similarly deductible.

1070.40 Patent rights sold and purchased [ss CB 30, DB 38, DB 39, DB 40, EI 4]
Any amount received by or owing to a taxpayer for the sale of a patent application with a complete specification, or from the sale of patent rights, is income — even when it takes a form other than cash. The income is derived in the year in which the amount is received or becomes owing to the taxpayer [s CB 30].
From the 2007-2008 income year, vendors of patent rights can elect to spread income on sale of patent rights evenly over three years — being the income year that it was derived and the following two income years [s EI 4].

A taxpayer who sells patent rights may deduct the following expenditure in the year of sale:

(a) If the taxpayer devised the invention to which the patent relates, the taxpayer may deduct any expenditure incurred in devising the invention, provided a deduction for that expenditure has not already been allowed. If the sale does not include all of the patent rights, a proportion of the expenditure is deductible. That proportion is the proportion that the amount derived from the sale of the patent rights bears to the market value of the whole of the patent rights on the date of sale [s DB 38].

(b) If the taxpayer acquired the patent rights before 1 April 1993, the taxpayer may deduct a proportion of the cost of acquisition. The proportion is of the unexpired term of the patent rights at the date of sale to the unexpired term of the patent rights at the date of acquisition [s DB 39]. See example below.

(c) If the taxpayer acquired the patent application or the patent rights on or after 1 April 1993, the taxpayer may deduct the cost of acquisition less the total of the amounts already allowed as depreciation deductions [s DB 40].

Example:
A taxpayer acquired patent rights (before 1 April 1993) for six years for $1,000. The taxpayer sells the patent rights after three years. The taxpayer is allowed a deduction of: $1,000 × ½ = $500.

Subpart EE (which deals with the disposal of depreciable property) does not apply to any expenditure deductible under (a), (b), or (c) above.

The above rules apply also to any share or interest in any patent rights.

1070.50 CIR’s interpretation statement

The CIR has issued a revised interpretation statement that examines the income tax treatment of New Zealand patents, patent applications, and patent rights [see TIB vol 18:7 (August 2006) at 37-67].

The conclusions reached in the statement can be summarised as follows:

(a) References in the legislation to a “patent” refer to the legal rights that the owner of the patent obtains as a result of the grant of that patent. In the case of New Zealand patents, this will be the legal rights obtained as the result of a patent granted under the Patents Act 1953;

(b) Other intellectual property rights are not patent rights and the patent does not include the invention that the patent relates;

(c) Expenditure on research and development, including that on the construction of prototypes, is in accordance with s DB 33 for scientific research [see 1240.10] and ss DB 34 and DB 35 for other research and development [see 1240.20] provided that the taxpayer both complies with the relevant requirements of FRS-13: Accounting for Research and Development Activities, and chooses to apply these sections. In other cases the treatment is as per the general deductibility provisions of ss BD 2, DA 1, DA 2, DA 3 and DA 4;

(d) The current statutory provisions relating to “patents” only affect income and expenditure incurred in the patenting process (ie typically the administrative and legal costs incurred in the application for the patent) not income and expenditure incurred in devising the invention to which the patent relates;

(e) Legal expenses incurred in either defending or attacking a patent are generally revenue in nature;

(f) A person who devised an invention for which a patent has been granted and who uses the patent for deriving income, is allowed a deduction for expenditure incurred before 1 April 1993 under s DB 38 [see 1070.30];

(g) If the person who devised the invention sells the patent rights relating to the invention, a deduction is allowed for the expenditure incurred in deriving the invention to the extent to which a deduction has not already been allowed under s DB 38 [see 1070.40];
Patents and Patent Rights

(h) When patent rights acquired on or after 1 April 1993 are sold, a deduction is allowed under s DB 40 of the total cost to the person of those patent rights less total amounts of depreciation loss [see 1070.40];

(i) The disposal of patent rights is the disposal of a capital item unless it is the rare situation where the taxpayer is in the business of buying and selling patent rights, in which case, patent rights are trading stock and their disposal is a revenue item. Patent rights which are trading stock are not depreciable; and

(j) An amount that a person derives from the sale of patent rights is income of the person [s CB 30, see 1070.40].
# Chapter 1080

## PAYE

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1080.05 PAYE income payments [s BE 1(1)]

Any person who makes a PAYE income payment must withhold tax from the payment under the PAYE rules. The PAYE rules specify how much tax must be deducted and when it must be paid to Inland Revenue.

1080.10 Definitions [ss RD 3, RD 5, RD 6, RD 7, RD 8, YA 1]

The following defined terms, listed in alphabetical order, are commonly used in the PAYE rules.

An “employee” [s YA 1] is a person who receives or is entitled to receive a PAYE income payment.

An “employer” [s YA 1] is a person who pays or is liable to pay a PAYE income payment, and includes:

(a) The manager or other principal officer of an unincorporated body of persons other than a partnership;
(b) Each partner in a partnership;
(c) Each person in whom the property has become vested or to whom control of the property has passed,
   for the estate of a deceased person, a trust, a company in liquidation, an assigned estate, or for any
   other property vested or controlled in a fiduciary capacity; and
(d) The Crown.

An “extra pay” [s RD 7] is a payment (not including overtime pay and exempt income) that is made to a
   person in connection with their employment, but is not a payment regularly included in salary or wages. Extra
   pays are excluded from the definition of salary or wages because they are taxed at a special rate. The payment
   may be made in one lump sum, or in two or more instalments. An extra pay includes:

(a) A bonus, gratuity, share of profits, or redundancy payment (defined below);
(b) A payment made when a person retires from employment;
(c) A payment made for a retrospective increase in salary or wages (ie backpay); and
(d) Income derived under a restrictive covenant [s CE 9], or for loss of vocation, position or status, or
   for leaving a position [s CE 10], in connection with an employment relationship between the payer
   and the payee.

A “redundancy payment” is a PAYE income payment paid:

(a) To a person whose employment in a position is terminated because the position has become
    superfluous to the requirements of their employer; and
(b) In compensation for the loss of the person’s employment.

Regular bonuses (ie incentive or production bonuses paid out more frequently than once a year) are not extra
   pays. They are treated as normal salary or wages. Backpay (a payment for a backdated salary increase) is an
   extra pay, but holiday pay and overtime pay are not. A payment for a retrospective increase in salary or wages
   is included in extra pay only to the extent that:
(a) 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
(b) When a week ends on a Saturday, the total of the backpay and the basic salary or wages for the week is more than $4.

A “pay period” [s YA 1] means the period for which regular payments of salary or wages are made to an employee. Typical pay periods are weekly, fortnightly, four-weekly and monthly.

A “PAYE income payment” [s RD 3] is:
(a) A payment of salary or wages;
(b) Extra pay; or
(c) A schedular payment.

The following are excluded from the definition of “PAYE income payment”:
(a) Amounts attributed under s GB 29. Section GB 29 attributes income from personal services to the person performing the services under certain conditions [see 740.30 to 740.50]. No tax deduction is required because the attributed income is not received in monetary form;
(b) An amount paid to a shareholder-employee of a close company in the circumstances set out in 1080.33; and
(c) An amount paid or benefit provided, by a person (the claimant) who receives a personal service rehabilitation payment from which tax has been withheld at the rate of 12.5 per cent under sch 4, Part I, or at the applicable rate under s RD 18, to another person for providing a key aspect of social rehabilitation [see 20.110].

The “PAYE rules” [s RD 2(1)] means:
(a) Section BC 1 (non-filing and filing taxpayers);
(b) Section LA 6 (remaining refundable credits: PAYE, RWT, and certain other items), s LB 1 (tax credits for PAYE income payments) and s LD 4 (tax credits for payroll donations);
(c) Sections RD 3 to RD 24 (PAYE deductions rules);
(d) Sections RP 2 to RP 16 (PAYE intermediaries); and
(e) Sections 15C to 15M, 24, 24B to 24P, 48, and 133, Part 9, and ss 167 to 169 of the TAA.

Salary or wages specifically includes the following items:
(a) Expenditure on account of an employee;
(b) Payments to working partners under s DC 4 and, for income year beginning on or after 1 April 2011, payments to working owners of look-through companies under s DC 3B;
(c) Periodic payments of pensions, allowances or annuities made to a person or their spouse [see 960.10], child, or dependent in connection with past employment;
(d) Payments of salary or allowances to members of Parliament;
(e) Payments of salary and principal allowances to judicial officers;
(f) A gratuitous payment made to a person in return for services provided to the payer by the person (or their parent, child, spouse, former spouse, or dependant) when the payment would not have been made if the services had not been provided;
(g) Payments of income-tested benefits;
(h) Payments of veterans’ pensions (excluding veterans’ pensions paid under s 74J(2)(b) of the War Pensions Act 1954);
(i) Payments of New Zealand superannuation (excluding New Zealand superannuation paid under s 26(2)(b) of the New Zealand Superannuation and Retirement Act 2001);
(j) Payments of living alone payments;
(k) Parental leave payments;
(l) Basic grants and independent circumstances grants provided to tertiary students;
(m) The market value of accommodation that a person receives in connection with their employment or service (not including a relocation payment under s CW 17B); and
(n) An employer’s superannuation cash contribution that the employee chooses to treat as salary or wages under s RD 68.

Salary or wages does not include:
(a) Exempt income, extra pays or schedular payments;
(b) Salary, wages or other income derived by a shareholder-employee that is, under s RD 3(3) and (4), not a PAYE income payment;
(c) Employers’ superannuation contributions (other than an employer’s superannuation cash contribution that the employee chooses to treat as salary or wages under s RD 68); or
(d) Payments excluded by regulation.

A “schedular payment” [s RD 8] is a payment of a type set out in sch 4 [see 1320 SCHEDULAR PAYMENTS]. If the payment relates to a sale, the schedular payment is the net amount paid after subtracting commission, insurance, freight, classing charges and other expenses incurred by the seller in connection with the sale. The definition of schedular payment specifically excludes:
(a) Salary or wages;
(b) An extra pay;
(c) A payment for services provided by a public authority, a local authority, a Maori authority, or a company (other than a non-resident contractor, a non-resident entertainer, or an agricultural, horticultural, or viticultural company);
(d) A payment covered by an exemption certificate provided under s 24M of the TAA;
(e) A payment for services provided by a non-resident contractor who has full relief from tax under a double tax agreement, and is present in New Zealand for 92 or fewer days in a 12-month period; or
(f) A contract payment for a contract activity or service of a non-resident contractor when the total amount paid for those activities to the contractor or another person on their behalf is $15,000 or less in a 12-month period.

1080.13 Requirement to make tax deductions [ss RA 1, RA 2, RA 5]

When an employer makes a PAYE income payment to an employee, the employer (or other person making the payment) must deduct tax from it and pay the tax to the CIR by the due date [s RA 5].

In TRA Case P44 (1992) 16 TRNZ 892, a New Zealand firm appointed a merchandise manager from overseas at a salary of $56,000 per annum and paid the employee a net monthly amount of $3,000 without accounting to Inland Revenue for the PAYE. The employee believed tax had already been paid on the amounts, but the CIR made amended assessments for the relevant income years on the basis that payments received by the employee were gross and therefore subject to tax in the hands of the employee. The employee objected and the objection was upheld. The responsibility of making PAYE deductions was on the employer. In this case, deductions were made by the employer, but were retained to assist the funding of its business. The employee’s wages were a PAYE income payment. It was not for the respondent to either tax the payments made to the employee as if they were gross, or to recover PAYE deductions from the employee.

1080.15 Payment in pay periods [s RD 15]

The following rules apply for the purpose of determining the amount of a tax deduction:
(a) If an employee in regular full-time employment is paid salary or wages for part of a pay period, the payment is treated as a payment for a full pay period.
(b) If an employee in regular full-time employment is paid salary or wages for part of a pay period, the payment is treated as a payment for a full pay period.

(c) If a PAYE income payment for a pay period is paid in two or more separate sums, those sums must be added together to determine the amount of tax for the payment.

(d) If it is impractical for an employer to pay an employee overtime pay and other salary or wages for a pay period at the same time, the employer may add the amount of the overtime pay of the employee to their salary or wages for a later pay period (but not to their overtime pay) if, for both pay periods:
   (i) The amounts of the employee’s salary or wages are more or less the same;
   (ii) The amounts of tax withheld from the employee’s salary or wages are the same; and
   (iii) The employee has the same tax code.

For this purpose, if overtime pay is paid for a period that is the same length as a pay period but does not coincide with a pay period, it may be treated as overtime pay for the pay period in which the period ends.

1080.16 CIR may determine if payment is subject to PAYE [s RD 3(5); TAA, 138M]

If a question arises whether the PAYE rules apply to all or part of a PAYE income payment, the CIR must determine the matter.

A person in respect of whom such a determination is issued cannot challenge or dispute the determination. Section 138E(1)(e)(i) prohibits a person from challenging a matter which, under the PAYE rules, is left to the determination of the CIR. An income tax dispute can be commenced only in respect of an assessment or a disputable decision. The definition of “disputable decision” in s 3(1) of the TAA [paragraph (b)(iii)] excludes a decision of the CIR which cannot be challenged and, as explained above, a s RD 3(5) determination cannot be challenged. However, a disputant may dispute a NOFA or challenge an assessment that is issued by the CIR in relation to an amount of tax withheld on the basis of a determination under section RD 3(5), on the ground that the determination is wrong, whether in fact or in law.

1080.17 Schedular payments [ss RD 8, RD 10(3), sch 4]

A person who makes a PAYE income payment (salary, wages, an extra pay or a schedular payment) is required to deduct tax from the payment. If the payment is made to an employee, PAYE (as set out in the PAYE tables) must be deducted. If the payment is a schedular payment and it is made to a non-employee, tax must be deducted at prescribed rates [see 1320 SCHEDULAR PAYMENTS].

1080.20 Amount of tax deduction from salary or wages [ss RD 9, RD 10, RD 11, LA 6, LB 1, sch 2]

The amount of tax to be deducted from PAYE income payments is the amount specified in sch 2. For normal payments of salary or wages, the amount of tax to deduct is determined using the PAYE tables published by Inland Revenue (IR340 Weekly and fortnightly PAYE deduction tables and IR341 Four weekly and monthly PAYE deduction tables). The amount of the deduction depends on the employee’s tax code [see 1080.25] and the amount of the payment. The rates of tax and earners’ levy shown below are those for the 2011-2012 income year.

If an employee has not provided their employer with a tax code declaration [see 1080.26], then tax must be deducted at the “no notification” rate of 45 cents in the dollar (47.04 cents including the earners’ levy).

The amount of tax deducted from an employee’s salary or wages during a tax year is credited against the employee’s income tax liability for the tax year. Any surplus credits are used to satisfy any income tax liability the employee may have for another tax year, and any remaining balance is refunded to the employee [see 1215.20].

Type of earnings (tax code) 1 April 2011 to 31 March 2012

Staples Tax Guide 2012
Secondary employment (SB) 10.5
Secondary employment (S) 17.5
Secondary employment (SH) 30.0
Secondary employment (ST) 33.0
Casual agricultural worker (CAE) 17.5
Election day worker (EDW) 17.5
Non-resident seasonal worker (NSW) 10.5

Note: The rates shown in the above table are cents per dollar of earnings, and do not include the earners’ levy. The earners’ levy is 2.04 cents in the dollar.

1080.22 Tax deduction exceeds PAYE income payment [ss RA 10, RD 21]
If the amount of a PAYE income payment available in money is less than the amount of the tax deduction (eg when a non-monetary PAYE income payment such as an accommodation benefit has been provided), the employee is required to pay the deficiency to the employer. The amount so paid is deemed to be a tax deduction made by the employer.

Example:
During a monthly pay period, a senior employee receives a salary payment of $4,000 and free accommodation with a value of $11,000. The total PAYE income payment is therefore $15,000. The tax that must be deducted by the employer from the PAYE income payment is $4,383 (at 2011-2012 rates, including the earners’ levy). However, the total cash from which to deduct the tax is only $4,000 (obviously tax cannot be deducted from the non-cash accommodation benefit), so the employee will be required to pay $383 to the employer. The employer will then pay the $4,383 tax deduction to Inland Revenue. If the employee fails to pay the required amount to the employer, Inland Revenue can recover the amount directly from the employee under s RD 4(2) [see 1080.85].

1080.24 PAYE deductions when new rates come into force [s RD 14]
The following procedures apply for the pay period in which a change occurs to the rates of tax for PAYE income payments set out in sch 2:
(a) Where the pay period does not exceed one month, deductions are to be made entirely at the new rate, whether it is higher or lower;
(b) Where the pay period is for more than one month, the pay is to be apportioned between the period before the date on which the change took place and the period after that date and tax is to be deducted from each portion at the respective rates in force during those periods; and
(c) Where, after the date on which a change comes into force, an employee receives a payment of salary or wages for a period ending before that date, tax is to be deducted at the old rate.

The following tax codes apply to PAYE income payments other than extra pays, schedular payments and income-tested benefits:

<table>
<thead>
<tr>
<th>Tax code</th>
<th>Application</th>
</tr>
</thead>
<tbody>
<tr>
<td>M</td>
<td>Primary employment earnings when the employee is not entitled to the transitional tax credit [s LC 4] or the independent earner tax credit [s LC 13].</td>
</tr>
<tr>
<td>ME</td>
<td>Primary employment earnings when the employee is entitled to the independent earner tax credit [s LC 13].</td>
</tr>
<tr>
<td>ML</td>
<td>Primary employment earnings when the employee is entitled to the transitional tax credit [s LC 4].</td>
</tr>
<tr>
<td>SB</td>
<td>Secondary employment earnings for an employee whose annual income is not more than $14,000.</td>
</tr>
</tbody>
</table>
PAYE 1080.25(1)

S Secondary employment earnings for an employee whose annual income is in the range $14,001 - $48,000.

SH Secondary employment earnings for an employee whose annual income is in the range $48,001 - $70,000.

ST Secondary employment earnings for an employee whose annual income exceeds $70,000.

CAE Salary or wages for employment as a casual agricultural employee.

EDW Salary or wages for employment as an election day worker.

NSW Salary or wages for employment as a non-resident seasonal worker.

No notification An employee who has not provided their employer with a tax code notification or tax code certificate.

When an employee receives an income-tested benefit and another PAYE income payment at the same time, the “S” tax code applies to the non-benefit income [TAA, s 24C].

The tax code applying to an employee’s parental leave payment is the same tax code that applied to the employee before the parental leave payments started, unless the employee provides another tax code notification [TAA, s 24D].

An employee with a student loan balance who expects their total income to exceed the annual repayment threshold must add “SL” to the end of their tax code. The employer is then required to deduct a student loan repayment as well as PAYE [see 1080.36].

(1) Employer using incorrect tax code

If an employer or a PAYE intermediary is using an incorrect tax code to calculate the tax deductions from PAYE income payments made to an employee, the CIR may notify the employer or the intermediary of the correct tax code and require the employer to apply this tax code to all future PAYE income payments to that employee. The tax code notified by the CIR may be superseded by a new tax code declaration supplied by the employee, if the employee’s circumstances change [TAA, s 24G].

(2) When entitlement to use tax code ends

When an employee is no longer entitled to use a particular tax code (eg because of a change in their circumstances), that tax code does not apply to future PAYE income payments unless the payment is salary or wages for a current pay period. The employee must notify their employer (or the CIR) that their entitlement has ended within four days after the date they became aware that they are no longer entitled to use the tax code. The employee must also give the reason why the tax code no longer applies and the date on which entitlement ended. If the employee provides their employer with a tax code notification or tax code certificate within seven days after the date on which they become aware that they are no longer entitled to use a tax code, the new tax code applies from the date on which the entitlement to use the earlier code ends. When an employee’s entitlement to use a particular tax code ends, their employer is not liable for withholding a reduced amount of tax for a payment if they have not received notice that the entitlement has ended.

An employee is not entitled to use the tax code “ML” in a tax year if the employee knows or expects, or should have known or expected, that they will not be entitled to a tax credit under s LC 4 [TAA, s 24H].

1080.26 Tax code declarations [TAA, ss 24B, 24I]

An employee is required to notify their employer that their tax code is one of the codes listed in 1080.25. If the employee fails to do this, tax is deducted from their salary or wages at the “no notification” rate (see 1080.20). An employee notifies their employer using a tax code declaration (IR330), which must be completed and delivered to the employer or payer of a schedular payment by:

(a) An employee on the commencement of employment;

(b) An employee who wishes to change their tax code; and
(c) A person to whom a schedular payment is to be made.

A separate declaration must be completed for each source of income (eg if a person has two employers, an IR330 must be completed for each employer). It is not necessary for an employee to complete a new tax code declaration at the start of each tax year.

The following information about the employee must be included in the tax code declaration:

(a) Name;
(b) IRD number;
(c) Correct tax code [see 1080.25];
(d) Type of schedular payment, if applicable;
(e) Whether the employee has a special tax code certificate;
(f) A statement that the employee is entitled to work in New Zealand; and
(g) The employee’s signature and date of signing.

The employer must ensure that a tax code declaration is fully completed for each employee. If an employee does not complete a tax code declaration, or omits their IRD number, tax code or any personal details, then the employer is legally obliged to deduct tax at the no notification rate. In the case of schedular payments, the no declaration rate is 15 cents in the dollar in addition to the appropriate tax rate.

1080.27 Special tax code certificates [TAA, s 24F]

The total amount of PAYE deducted from an employee’s earnings during a tax year will normally approximate the employee’s total income tax liability for that year (assuming this is their only income source). However, special circumstances may mean that tax deductions at the table rates will lead to a significant over or under-deduction of tax for the year. Such over or under-deduction may occur if:

(a) The employee has two or more jobs and the “S” tax rate is insufficient to meet the overall tax liability;
(b) The employee has an available net loss that can be offset against their employment income;
(c) The employee receives commissions or bonuses that vary erratically, so that normal tax deductions are excessive;
(d) The employee has a student loan and wants to make loan repayments over and above the statutory amounts;
(e) The person receives an overseas pension that is taxable in New Zealand; or
(f) The employee qualifies for hardship relief [see 480 FINANCIAL RELIEF].

In circumstances such as these, the employee can apply to Inland Revenue for a special tax code certificate. If Inland Revenue decides to issue a special tax code certificate, the certificate will specify that deductions be made from the employee’s earnings by:

(a) Deducting tax using a specified tax code;
(b) Making tax deductions at a certain rate (including a nil rate);
(c) Deducting the earner levy only; or
(d) Making student loan deductions at a specified rate.

A special tax code certificate does not take into account working for families tax credits. A person entitled to a WFF tax credit must apply for this in the normal way [see 420.05 to 420.15].

Non-resident seasonal workers cannot apply for a special tax code certificate [see 1080.31].

On receipt of a valid special tax code certificate issued by Inland Revenue and signed by the employee, the employer must deduct tax at the rate, or using the tax code, specified in the certificate. A special tax code certificate is valid only for the period stated on the certificate. At the end of that period, the employee must either obtain a new special tax code certificate or complete a tax code declaration (IR330). Further information about special tax code certificates can be found in TIB vol 6:9 (February 1995) at 1-2.
Inland Revenue may cancel a special tax code certificate at any time, and the employee must return the certificate to Inland Revenue within seven days of receiving notice of cancellation. In Commissioner of Inland Revenue v Lemmington Holdings Ltd [1982] 1 NZLR 517, (1982) 5 NZTC 61,268 (CA) the Court of Appeal granted no relief where the CIR sought to withdraw special tax codes certificates previously granted.

**1080.30 Extra pays [ss RD 10(2), RD 17, sch 2, Part B]**

Extra pays are excluded from the definition of “salary or wages”, and the tax deduction rates set out in the PAYE tables do not apply to them.

The rate at which tax is to be deducted from an extra pay [see 1080.10 for the definition] depends on the total of the extra pay and the annualised value of all other PAYE income payments paid to the employee by the employer in the four weeks preceding the day the extra pay is paid [s RD 17]. The following table (based on sch 2, Part B) summarises when the various rates apply.

<table>
<thead>
<tr>
<th>Annualised remuneration plus extra pay</th>
<th>Rate of deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 - $14,000</td>
<td>10.5%</td>
</tr>
<tr>
<td>$14,001 - $48,000</td>
<td>17.5%</td>
</tr>
<tr>
<td>$48,001 - $70,000</td>
<td>30%</td>
</tr>
<tr>
<td>$70,001 upwards</td>
<td>33%</td>
</tr>
</tbody>
</table>

**Note:** The earners’ levy [see 1080.20] is added to the deduction rates shown above.

An employee who has provided their employer with a tax code declaration may choose to have an extra pay taxed at a higher rate [s RD 10(2)].

**Example:**

Dion received wages of $1,380 for the two weeks ended 6 August and $1,470 for the two weeks ended 20 August. With his pay for the two weeks ended 20 August, he also received a payment of $5,000 for a backdated wage increase. The backpay is an “extra pay”. The annualised value of his PAYE income payments (other than the extra pay) for the four weeks preceding the payment of the extra pay is:

\[
\frac{(1,380 + 1,470)}{4} \times 52 = 37,050
\]

The total of this and his extra pay is $42,050 ($37,050 + $5,000). The applicable rate of tax to deduct from the extra pay is (as per the above table) therefore 17.5 per cent. The amount of tax (excluding the earners’ levy) to be deducted from the extra pay is $5,000 × 17.5% = $875. Dion could (if he had other sources of income that meant that his total income for the year would exceed $48,000) elect, by completing a tax code declaration, that tax be deducted from the extra pay at 30 per cent or 33 per cent, as applicable.

**1** Extra pays relating to secondary employment [s RD 17(3), (4)]

If an employer pays an amount of extra pay to an employee who has notified the employer that a secondary tax code applies, the tax rate applicable to the extra pay is based on the following amount:

\[
\text{extra pay + annualised amount + low threshold amount}
\]

Where:

“Extra pay” is the amount of the extra pay;

“Annualised amount” is as explained above;

“Low threshold amount” is as follows:

<table>
<thead>
<tr>
<th>Secondary code</th>
<th>Low threshold amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>SB</td>
<td>$0</td>
</tr>
<tr>
<td>S</td>
<td>$14,001</td>
</tr>
<tr>
<td>SH</td>
<td>$48,001</td>
</tr>
<tr>
<td>ST</td>
<td>$70,001</td>
</tr>
</tbody>
</table>

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1080.31 Casual agricultural employees and non-resident seasonal workers [ss YA 1, YD 1(11), sch 2; TAA, ss 24B, 24F, 33A]

1. Casual agricultural employees

A “casual agricultural worker” is defined as a person engaged on a day-to-day basis for up to three months as a casual seasonal worker for the exclusive purpose of doing seasonal agricultural, horticultural, market gardening, nursery, orchard, or tobacco farming work, or other similar seasonal work [s YA 1, see 430.190].

A “shearer” is defined as a person who undertakes the shearing of sheep, but who is not carrying on a business and is not permanently employed on the premises where the shearing shed is situated [s YA 1].

A “shearing shed hand” is a person who is employed in or about the shearing shed but is not carrying on a business. Shearers, wool classers and persons permanently employed on the premises where the shearing shed is located are not shearing shed hands [s YA 1].

2. Non-resident seasonal workers [ss YA 1, YD 1(11), sch 2; TAA, ss 24B, 24F, 33A]

“Non-resident seasonal workers” (commonly referred to as migrant workers) are non-resident individuals who are employed to undertake work in New Zealand under the recognised seasonal employment scheme. The “recognised seasonal employment scheme” is the recognised seasonal employer policy published by the Department of Labour under s 13A of the Immigration Act 1987 [s YA 1].

Non-resident seasonal workers are treated as non-residents while they are employed under the recognised seasonal employment scheme, even if they are personally present in New Zealand for more than 183 days in total in a 12-month period.

The special tax code “NSW” applies to salary or wages earned by non-resident seasonal workers. These earnings are taxed at the flat rate of 10.5 cents in the dollar.

Non-resident seasonal workers cannot apply for a special tax code certificate. A non-resident seasonal worker is not required to file an income tax return if they have used the “NSW” tax code.

1080.32 Election day workers [s YA 1, sch 2, cl 7]

“Election day workers” are defined as people engaged to work for an election or poll held under the Electoral Act 1993, the Local Electoral Act 2001, or the Local Restoration Polls Act 1990. This applies only to work done or services rendered immediately before, on or immediately after the day on which the election is held or poll is taken, and where the worker is paid by the authority controlling the election or poll.

Payments to election day workers (tax code “EDW”) have tax deducted at the rate of 19.54 cents in the dollar (including the earners’ levy).

1080.33 Shareholder-employees of close companies [s RD 3(2)-(4)]

If the conditions set out below apply for an income year:

(a) The person may choose to treat all amounts paid to them in that income year, in their capacity as employee of the close company, as income that is not a PAYE income payment; and

(b) All amounts paid to the person in later income years, in their capacity as employee of the close company, are treated as income that is not a PAYE income payment.

The conditions that must be satisfied are:

(a) The person is a shareholder-employee of a close company; and

(b) The person does not derive, as an employee, salary or wages of a regular amount for regular pay periods:

(i) Of one month or less throughout the income year; or

(ii) That total 66 per cent or more of the annual gross income of the person in the corresponding tax year as an employee; or
(c) An amount is paid as income that may later be allocated to the person as an employee for the income year.

The effect of this treatment is that the company is not required to deduct PAYE from payments of employment income to the shareholder-employee, and the shareholder-employee will be responsible for paying the tax on that income (including provisional tax, if applicable).

A “close company” is defined as a company to which either of the following conditions applies:
(a) There are five or fewer natural persons the total of whose voting interests in the company is more than 50 per cent (treating all associated natural persons as one natural person); or
(b) A market value circumstance exists for the company and there are five or fewer natural persons the total of whose market value interests in the company is more than 50 per cent (treating all associated natural persons as one natural person).

For the purposes of s RD 3(2)-(4), a “close company” also means a company with 25 or fewer shareholders.

A special corporate entity cannot be a close company [s YA 1].

1080.34 Non-residents [ss BD 1, CW 19, HD 27, YD 1]

Generally, non-residents are liable for New Zealand income tax on all income derived from New Zealand. Thus if a non-resident works for a New Zealand employer, the employer will deduct PAYE from the non-resident’s salary or wages in the same way as for a resident [see 1000.25].

Foreign-sourced income of non-residents is not assessable income [s BD 1(5)(c)]. The residency rules are explained in 1250 RESIDENCE. A non-resident whose stay in New Zealand is no more than three months may be exempt from tax on employment income received from a foreign employer. Income derived by a non-resident from personal or professional services performed in New Zealand during a visit is exempt if:
(a) The visit is not for more than 92 days (including the days of arrival and departure);
(b) The total of that visit and all other visits to New Zealand in the same tax year is no more than 92 days;
(c) The services are performed for a non-resident employer; and
(d) The remuneration received is chargeable with a tax, in the person’s country of residence, that is substantially the same as New Zealand income tax [s CW 19].

The exemption does not apply to public entertainers (eg musicians, actors and professional sportspersons). “Public entertainer” is defined to include:
(a) Circus performers, dancers, lecturers, motion picture artists, musicians, radio artists, singers, television artists, and theatre artists; and
(b) Athletes, boxers, wrestlers, and other professional sports persons.

A non-resident may also be exempt from tax on income from personal services under a double tax agreement [see 310 DOUBLE TAX AGREEMENTS]. For example, under art 15 of the Australia-New Zealand double tax agreement, the remuneration of an Australian resident individual working in New Zealand is not taxable in New Zealand if:
(a) The individual is present in New Zealand for less than 183 days in total in any 12-month period;
(b) The remuneration is paid by an employer who is not resident in New Zealand;
(c) The remuneration is not deductible in determining the taxable profits of a permanent establishment or a fixed base that the employer has in New Zealand; and
(d) The remuneration is taxable in Australia.

The same would apply to a New Zealand resident working in Australia.

An employer who employs a non-resident person with an income tax liability is treated as an agent in relation to the employment income derived in New Zealand by the nonresident person. If the non-resident does not meet their income tax liability, the employer must withhold the amount of income tax payable from their employment income and pay it to the CIR on the person’s behalf. A non-resident trader who employs a person...
in New Zealand is treated as an agent in relation to the person’s employment income. If the trader has an 
agent in New Zealand, the agent must meet the trader’s obligations under s HD 3 [s HD 27].

1080.35 **ACC earner levy**
All employees must pay the ACC earner levy [see 20.20]. For employees, the earner levy is deducted by the 
employer from salary and wages along with PAYE tax deductions and paid to Inland Revenue on the same 
due dates as for PAYE. Inland Revenue collects these levies on behalf of the ACC [see 20 ACCIDENT 
COMPENSATION]. The earner levy is built into the PAYE tables. The earner levy is not deducted from any 
employee earnings which exceed the maximum earnings [see 20.35]. The earner levy does not apply to 
schedular payments [see 1320 SCHEDULAR PAYMENTS. People receiving schedular payments are 
responsible for paying their own ACC levies [see 20.25].

1080.36 **Student loan deductions**
A person with an outstanding student loan balance is required to make a student loan repayment at the rate 
of 10 cents in the dollar on every dollar earned in excess of the annual repayment threshold. The annual 
repayment thresholds are listed in 1380.10.

If an employee’s tax code includes “SL”, the employer is required to make student loan deductions in addition 
to PAYE [see 1080.40 Example 9].

1080.37 **Child support deductions**
An employer may be required to deduct child support from the earnings of employees who are liable parents 
[see 160 CHILD SUPPORT]. Child support has priority over all other deductions from an employee’s pay, 
except from PAYE. The employer responsibilities are outlined in 160.140.

1080.40 **Examples of PAYE deductions**
The following examples are based on the rates of tax applicable to the year ended 31 March 2012. PAYE in 
these examples has been calculated using the PAYE tables published by Inland Revenue (IR340 and IR341). 
These amounts will vary slightly if calculated using the Inland Revenue online PAYE calculator.

PAYE is paid on whole dollars of earnings only. If the exact amount of earnings is not shown in the “Earnings” 
column in the PAYE table, then the tax deduction for the next lowest amount is taken. PAYE deductions 
include the earners’ levy.

**Example 1 (weekly wage plus overtime):**
Rod receives weekly wages of $538.42 plus overtime pay of $165.83. His total pay for the week is $704.25. His tax code is “M”. 
The amount of PAYE to deduct from Rod’s earnings, as per the weekly PAYE table, is $118.71.

**Example 2 (fortnightly salary plus annual bonus):**
Kelly is paid her fortnightly salary payment of $2,307.69 and a yearly performance bonus of $6,000. Kelly’s pay for the previous 
fortnight was her normal salary of $2,307.69. Her tax code is “M”. The amount of PAYE to deduct from her salary, as per the 
fortnightly PAYE table, is $470.38. The bonus is an extra pay — the rate of tax to deduct from it depends on Kelly’s annualised 
PAYE income payments. Her annualised PAYE income payments for the previous four weeks, including the bonus, are 
($2,307.69 × 2 × 52/4) + $6,000, or $66,000. As this is between $48,001 and $70,000, tax must be deducted from the bonus at 
the rate of 32.04 per cent (including the earners’ levy). The amount of tax to deduct from the bonus is $1,922.40. The total tax 
deduction from Kelly’s fortnightly pay is therefore $2,392.78 ($470.38 + $1,922.40).

**Example 3 (monthly salary):**
Hemi receives a monthly salary payment of $7,000. His tax code is “M”. The amount of PAYE to deduct from Hemi’s salary, 
as per the monthly PAYE table, is $1,696.11.

**Example 4 (high monthly salary):**
Susan, the CEO of a major corporation, receives a monthly salary payment of $12,500. Her tax code is “M”. The maximum 
earnings figure listed in the monthly PAYE table is $10,000. To calculate the amount of tax deductible from earnings of $12,500, 
we take the tax on $10,000 ($2,733.16), as per the table, and add to it tax on the excess over $10,000 at the rate of 33 per cent
($825). The total tax deduction from Susan’s salary is therefore $3,558.16 ($2,733.16 + $825). Note that the earners’ premium is not deducted from any earnings in excess of $111,669 a year ($9,305 a month).

Example 5 (wages at no notification rate):
Alain has recently been employed as a labourer on a building site. He is paid gross wages of $876.32 for his first two weeks of employment. Alain has not provided his employer with a signed tax code declaration when his wages are paid. Tax must be deducted from his wages at the “no notification” rate of 47.04 cents in the dollar (including the earners’ levy). The tax to be deducted from Alain’s wages is $412.07 ($876 × 47.04%).

Example 6 (holiday pay):
Rhonda has just resigned from her job and is paid holiday pay (based on eight per cent of her gross earnings for the income year to date) of $2,443.27 on the day she leaves. Her normal fortnightly salary was $1,346.15. Her tax code is “M”. Her normal weekly salary was $673.07 ($1,346.15 / 2). Her holiday pay is equivalent to three normal weeks’ salary of $673.07 plus one partial week’s salary of $424.06. Tax on $673.07, per the weekly PAYE table, is $112.65. Tax on $424.06, per the weekly PAYE table, is $64.00. The total tax deduction from Rhonda’s holiday pay is therefore $401.95 ($112.65 × 3 + $64.00).

Example 7 (income under $9,880):
Peter works part-time for a supermarket. His wages for the week are $169.45. His tax code is “ML”. The tax to be deducted from Peter’s wages, as per the weekly PAYE table, is $17.66.

Example 8 (secondary employment):
Ngaio has two jobs. Her main full-time job is as a receptionist. She also has a part-time job sorting mail in the evenings. Her fortnightly wages for mail sorting are $576.92. Her tax code is “SH” (she estimates that her total annual earnings from all sources will be between $48,001 and $70,000). The tax to be deducted from Ngaio’s wages from mail sorting, as per the PAYE table for secondary earnings, is $184.55.

Example 9 (student loan repayment):
Steve graduated from university three years ago and is employed by a law firm. He took out a student loan to pay for his education. Steve’s fortnightly salary is $2,500. His tax code is “M SL”. The tax to be deducted from Steve’s salary is $532.52 and the student loan deduction to be made is $176.60, as per the fortnightly PAYE table. The total deduction is therefore $709.12.

Example 10 (casual agricultural employee):
The owner of a large commercial orchard employed Olga as a seasonal fruit picker. She is paid weekly on the basis of the quantity of fruit she picks. The fruit picking work will only last for about two or three weeks. For the first week, Olga earns $437. Her tax code is “CAE”. The tax rate applicable to casual agricultural employees is 19.54 cents in the dollar. The amount of tax to be deducted from Olga’s earnings is therefore $85.39 ($437 × 19.54%).

**Awards for lost wages [ss CE 1, CA 1, RA 5, RD 4(2)]**
The receipt by an employee of an award under the Employment Relations Act 2000 for lost wages or other remuneration is employment income under s CE 1. The payment is an extra pay and a PAYE income payment, and the employer is liable to make a tax deduction from it under s RA 5. If the employer fails to make a tax deduction, the employee is liable under s RD 4(2) to pay an amount equal to the tax deduction to Inland Revenue, and is also required to provide Inland Revenue with an employer monthly schedule. See public ruling BR Pub 06/06 [see TIB vol 18:7 (August 2006) at 17-26], which applies from 1 October 2005.

However, payments that are genuinely and entirely for compensation for humiliation, loss of dignity, or injury to feelings under s 123(1)c(i) Employment Relations Act 2000 are not income under ss CE 1 or CA 1(2), and there is no liability for employers to deduct PAYE from such payments. See public ruling BR Pub 06/05 [see TIB vol 18:7 (August 2006) at 9-16], which applies from 1 October 2005.

**Bonuses**
Bonuses such as annual or special one-off bonuses, that are not paid regularly, are taxed as extra pays [see 1080.30]. Regular bonuses, such as incentive or production bonuses paid out more often than once a year, are not extra pays. They are treated as normal salary or wages. If the bonus relates only to one pay period, then the bonus is added to the other salary or wages for that period and PAYE is deducted from the total. If the bonus relates to more than one pay period, then the method shown in the following example is used.
Example:
Bill is paid fortnightly, and receives a production bonus each month. His last two fortnightly gross wage payments were $1,028 and $1,076. He received his monthly bonus payment of $475 with his last fortnightly wages. His tax code is “M”. Tax on the two fortnightly wage payments is calculated as usual using the fortnightly PAYE tables. Tax on $1,028 is $163.16. Tax on $1,076 is $172.54. Tax on the bonus is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total wages for month ($1,028 + $1,076)</td>
<td>$2,104.00</td>
</tr>
<tr>
<td>Plus monthly bonus</td>
<td>$475.00</td>
</tr>
<tr>
<td>Total income</td>
<td>$2,579.00</td>
</tr>
<tr>
<td>Tax on total income (per monthly PAYE table)</td>
<td>$421.46</td>
</tr>
<tr>
<td>Less tax on normal wages ($163.16 + $172.54)</td>
<td>$335.70</td>
</tr>
<tr>
<td>Tax to deduct from bonus</td>
<td>$85.76</td>
</tr>
</tbody>
</table>

Tax of $163.16 will be deducted from Bill’s first fortnightly wage payment of $1,028; and tax of $258.30 ($172.54 + $85.76) will be deducted from his combined second fortnightly wage payment and bonus of $1,551 ($1,076 + $475).

1080.53 Commission agents
Commission agents (eg real estate or life insurance agents) are individuals who receive commissions on sales they make. If the agent is paid only on commission, the commissions are treated as schedular payments and taxed at the rate of 20 cents in the dollar [see 1320.30]. If the agent receives a salary or other fixed remuneration as well as a commission, the agent will be treated as an employee and PAYE will be deducted from both the fixed remuneration and the commission.

1080.54 Holiday pay
Employees have a statutory entitlement to be paid for annual leave and statutory holidays (Christmas day, Easter Monday, and so on) that fall during the period of their employment. Holiday pay does not include long service leave, retirement leave, sick leave, or any other accruing employee remuneration. Holiday pay and pay for statutory holidays are included as earnings in the pay period in which they are paid.

To calculate PAYE on annual leave, treat it as if it were received as normal salary or wages. For example, if an employee who is normally paid weekly receives three weeks’ annual leave pay before going on leave, that pay is divided by three and tax deducted from each third at the normal rate as per the weekly PAYE tables [see 1080.40 Example 6].

While an employer may have incurred expenditure on account of holiday pay, the allocation of the allowable deduction is delayed until such time as payments for the holiday leave are paid to the employee [see 230.175].

1080.55 Honoraria
If an honorarium is paid to a person who is also an employee of the payer, both the honorarium and the employment earnings will be subject to PAYE, including the earner levy. For example, if a person employed as a secretary of a golf club is paid an honorarium in addition to wages, both the wages and the honorarium will be liable for PAYE.

Honoraria paid to persons who are not employees (including mayors, chairperson and members of councils, boards, committees and other like bodies, and officials of societies, clubs and similar organisations) are subject to tax at the rate of 33 per cent. The earner levy does not have to be deducted from such honoraria. Honoraria paid to school trustees are schedular payments and also subject to tax at the rate of 33 per cent.

1080.56 IR56 taxpayers [s RD 16]
Certain categories of employee (IR56 taxpayers) are responsible for paying their own PAYE tax. IR56 taxpayers include:

(a) Private domestic workers who work part-time, such as homeelpers, caregivers, nannies, gardeners and domestic odd-jobbers;

(b) Embassy staff;
(c) New Zealand-based representatives of overseas companies; and
(d) United States Antarctic Program personnel.

A person employing an IR56 taxpayer is not required to deduct tax from salary or wages paid to them.

**Example:**

Polly works as a house cleaner for five different householders. She averages around eight hours per week per householder. Although she works a total of more than 30 hours a week, she is still an IR56 taxpayer as she fits the definition of a private domestic worker. This is because she is not working full time for any one employer, she works in the employers’ homes and is paid directly by each employer. Polly is responsible for paying the PAYE on her IR56 income.

IR56 taxpayers calculate the tax deduction from their total earnings each month in exactly the same way as an employer would do for an employee. They must complete and send an Employer deductions (IR345) form and an Employer monthly schedule (IR348) to Inland Revenue with their tax payment each month. In addition, they must keep a record on the IR56 summary forms of their monthly gross wages and PAYE tax deductions. The IR56 is kept by the IR56 taxpayer as a permanent record of their wages and tax deductions.

IR56 taxpayers who have a student loan and are embassy staff members, New Zealand-based representatives of overseas companies or Operation Deep Freeze workers, are also responsible for making monthly student loan repayment deductions from their earnings, if applicable.

1. **Payments to private domestic workers [s RD 16]**

No tax is required to be withheld for a PAYE income payment relating to a person’s employment as a private domestic worker. This applies to a person who is employed as a private domestic worker by another person and:

(a) The employer is the occupier, or one of the occupiers, of a house or premises used exclusively for residential purposes; and

(b) The employment:

   (i) Is for the performance of work in or about the house or premises, or a garden or grounds belonging to the house or premises;

   (ii) Is not for a business carried on by the employer, or an occupation or calling of the employer; and

   (iii) Is not regular full-time employment.

**1080.57 Income received fraudulently or in error**

Property received fraudulently is assessable income under s CB 32 [see 710.80], but because the recipient is not entitled to the income it is not a PAYE income payment. If PAYE is deducted from the payment, the CIR will repay the deduction to the payer on request in writing. The amount assessed to the recipient is the net amount of the fraudulent payment (ie the amount actually received by them). The recipient is then responsible for meeting their tax liability on that income. If the recipient repays any of the income, they can claim a deduction in the year of repayment under s DB 44.

**Example:**

An employee responsible for salary and wages at a small company makes fraudulent payments to himself on a fortnightly basis of $200. The employer discovers this theft as part of an audit after 24 weeks. In total, the employee received an additional $2,400. The employee received $2,099.04 net and $300.96 was paid as PAYE in the employee’s name. The employee will be assessed income of $2,099.04. The $300.96 paid as PAYE should be repaid to the employer.

Where an employer has, in error, paid an employee an amount to which the employee is not entitled, it is not income the employee is entitled to (unless s CB 32 applies). Therefore, it is not a payment subject to PAYE and Inland Revenue will return any tax deduction to the employer on request in writing. Income that is received in error and repaid will not be assessable to the employee, and the employee cannot claim a deduction in the year of repayment. If an overpayment of salary or wages occurs through simple oversight, and is immediately identified and corrected within the same period, Inland Revenue will permit the employer to correct the matter in the employer monthly schedule filed.
Where income is received in error by way of a benefit, the person is not entitled to the receipt of it (unless s CB 32 applies). The rules are the same as for salary and wages. The overpayment is not a PAYE income payment and PAYE does not apply. The recipient has an obligation to repay the amount received. If deducted, the PAYE would be returned by Inland Revenue to the payer, usually WINZ, on request in writing. If the recipient repays the benefit received in error they get no deduction for the repayments [see TIB vol 16:11 (December 2004) at 17-18].

1080.58 Musicians

Where musicians, bands or other entertainers are employees, PAYE should be deducted from payments made to them. Payments made to musicians hired on a casual basis are prepayment payments and subject to tax at the appropriate rate [see 1320.30]. If the leader of the band is in business, the business owner may apply for a certificate of exemption. Payments by the band leader to band members are subject to PAYE.

1080.59 Outworkers and pieceworkers [s RD 15(2)]

If an outworker is paid on a production basis (based on output), PAYE must be deducted from the payment. The payment is deemed to be for the period from the commencement of the work until the work is completed. Normally, pieceworkers employed in factories are paid on a weekly or other regular pay period basis and present no difficulty. Tax deductions are arrived at in the normal way.

Where payments for piecework or outwork are made for irregular periods, the procedure is as follows:

(a) The payments are treated as having been derived uniformly over the period in which the work was performed.

(b) The period must be split from commencement to completion into complete weeks, and the payment allocated in accordance with (a) above. Where the period does not divide equally into even weeks, the amount applicable to the odd days must be treated as being for an extra week, and should be added to any other amount allocated to be deducted.

(c) Tax must be calculated for each week separately. The aggregate of the deductions for each separate week is the total amount to be deducted.

Payments to labour-only contractors in the building industry are schedular payments liable for tax at the appropriate rate [see 1320 SCHEDULAR PAYMENTS].

1080.60 Prize money at sporting events

Prize money paid at sporting events or competitions is a schedular payment subject to tax at the rate of 20 per cent. This applies to both professional and amateur events. However, the first $500 per event or competition is effectively exempt [see 1320.30].

1080.61 Sales competition prizes

Where businesses conduct one-off selling competitions among their salespeople, the question arises as to the assessability of the prizes or trophies (other than cash) awarded in such competitions. Non-cash prizes or trophies are not assessable income to the salespeople (although they may be subject to FBT), but prizes awarded in cash are assessable. The cost of the prizes or trophies is deductible to the employer, as are cash prizes.

This was confirmed in Sixton v Commissioner of Inland Revenue (1982) 5 NZTC 61,285 (HC), where a taxpayer received a prize in the form of a points cheque that could be redeemed only for travel vouchers or goods (not cash). The High Court ruled that the benefit was not an allowance and therefore not assessable. However, prizes of this sort may be liable to FBT if they constitute a benefit that an employee derives “in connection with their employment” [s CX 2(1)].

1080.62 Shearers, drovers and musterers

Payments to shearers and shearing shed hands are subject to PAYE at flat rates, although some allowances are exempt. Payments to shearing contractors are schedular payments subject to tax at the specified rate [see 430.190 and 1320.40].
Payments to drovers and musterers for casual work are subject to PAYE. However, allowances paid for dogs, horses and saddlery are exempt [see 430.195].

**1080.63 Students and school children** [s LC 3]

School children earning income are liable to income tax in the same way as other taxpayers. However, they may qualify for the school child tax credit, which effectively exempts the first $2,340 of annual gross income (excluding interest and dividends) [see 1395.55].

School children whose total earnings from all employment do not exceed $45 per week ($2,340 a year) are not required to complete a tax code declaration (IR330), and no PAYE is required to be deducted from their earnings. This is because the school child tax credit would result in this tax being refunded to the child at the end of the year. School children who earn more than $45 per week are required to complete a tax code declaration, and tax must be deducted from the full PAYE income payment. When weekly earnings exceed $45 a week but the annual earnings are not expected to exceed $2,340 (eg when a child works full time during the holidays but will not earn more than $2,340 in total), the child is not required to fill in a tax code declaration and no tax should be deducted from their earnings.

With university, polytechnic and other tertiary students, tax should be deducted from employment earnings. If a student is only working for part of a year, the PAYE tables will result in tax being over-deducted. In this situation, the student may be best advised to apply for a special tax code certificate [see 1080.27] rather than wait for an annual assessment and a refund at the end of the year.

**1080.64 Voluntary labour projects**

Some organisations such as charities, which are exempt from tax, contract for their members to undertake work and apply the proceeds for the purposes of the organisation. The income is exempt from tax provided:

(a) The object is charitable [see 150 CHARITIES];
(b) The organisation itself arranges the contract with the principal and undertakes to carry out the work;
(c) The organisation arranges with its members to do the work. The members are then working for the organisation and not the principal;
(d) The members do the work, without remuneration, in their spare time and not as part of their ordinary occupation or employment; and
(e) The organisation receives payment direct from the principal.

Tax should not be deducted because the members do not receive remuneration for the work performed.

These arrangements for labour projects and working bees should not be confused with a person or persons undertaking work personally and directing the employer to pay the proceeds to a charitable or other organisation. In such instances, because the organisation does not make the contract with the employer and the employees are not working for the organisation, the income remains the income of those doing the work and is subject to tax. If the payment is to a charity it may qualify for a charitable donation rebate [see 1395.75].

**1080.75 CIR may reduce tax deductions** [s RD 11]

The CIR may, in special circumstances, reduce the amount of tax for a PAYE income payment to an employee or a class of employees. The PAYE rules then apply as if amended.

If the amount of tax for a PAYE income payment cannot be determined under sch 2 or under regulations because of the size of the PAYE income payment, or the number of the employee’s dependants, or for any other reason, the amount of tax for the payment must be determined by the CIR, taking into account the factors considered in fixing the amount of tax for other similar payments. The amount of tax for an income-tested benefit, or an allowance paid under regulations made under the Education Act 1989, must be determined by the CIR in consultation with the chief executive of the administering department or the Secretary of Education.
If the CIR makes a determination under s RD 8(3) of the amount or proportion of expenditure incurred in deriving a schedular payment [see 1320.40], tax is calculated on the net amount of the payment after the deduction of that expenditure. This overrides s RD 10(3) [see 1080.17].

1080.80 Payment of tax deductions to Inland Revenue [ss RA 5, RA 15, RD 4, RD 22; TAA, ss 24J, 24P]

Employers who make deductions of tax from PAYE income payments are required to pay those deductions to Inland Revenue on a regular basis, together with any:

(a) ESCT deductions [see 1080.105];
(b) KiwiSaver deductions [see 860.70];
(c) KiwiSaver employer contributions [see 860.85 and 860.87]; or
(d) Payroll donations [see 1395.77].

Each payment of tax deductions to Inland Revenue must be accompanied by a PAYE payment form (Employer deductions, form IR345), and each month an employer monthly schedule must be delivered to Inland Revenue summarising gross earnings and deductions for each employee [see 1080.95 and 1080.97]. The time for accounting to Inland Revenue for tax deductions depends on the total amount of tax deductions made each year.

1080.81 Large employers [ss RA 15, RD 4(1), RD 22]

Employers whose gross PAYE and ESCT deductions exceeded $500,000 in total for the preceding tax year are required to account for PAYE tax deductions in two instalments per month as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>On or before the 20th of the month</td>
<td>Pay to Inland Revenue tax deducted in the first 15 days of the month, and supply a PAYE payment form covering those deductions.</td>
</tr>
<tr>
<td>On or before the fifth of the month (the 15th in the case of January)</td>
<td>Pay to Inland Revenue tax deducted between the 16th and the end of the preceding month, and supply an employer monthly schedule and a PAYE payment form covering those deductions.</td>
</tr>
</tbody>
</table>

**Example:**

During the year ended 31 March, Jones Ltd deducted a total of $578,943 in gross PAYE tax deductions and ESCT from employees’ earnings. Jones Ltd is therefore a large employer. The company will be required to pay to Inland Revenue on or before 20 April, PAYE deducted from wages and salaries paid during the period 1 to 15 April. It will be required to pay to Inland Revenue on or before 5 May, PAYE deducted from wages and salaries paid during the period 16 to 30 April. A PAYE payment form must accompany each payment, and the payment on 5 May must also be accompanied by an employer monthly schedule.

1080.82 Small employers

Employers whose gross PAYE and ESCT deductions were less than $500,000 in total for the preceding tax year are required to account for PAYE tax deductions only once each month, on the 20th of the month. By this date, small employers must pay to Inland Revenue tax deducted during the preceding month, and supply an employer monthly schedule and a PAYE payment form.

1080.83 New employers [s RD 22]

If the employer was not an employer in the preceding tax year, the employer must account for PAYE tax deductions on the same monthly basis as for small employers until such time as the gross tax deductions and ESCT exceed, for the year to date, $500,000 in total. Once this total has been exceeded, the employer must account for tax deductions twice a month, as for large employers.

Inland Revenue may exempt an employer from providing a PAYE payment form if the information required in the form is provided in the employer monthly schedule. If the employer uses a PAYE intermediary [see 1090 PAYE INTERMEDIARIES], the PAYE obligations apply to the intermediary, not the employer.
1080.85  Payment of deductions by employee [s RD 4(2)]

If for any reason the employer does not deduct tax from a PAYE income payment, the employer must, on or before the 20th of the month following the month in which the PAYE income payment was made:

(a) Provide the CIR with an employee monthly schedule containing those particulars that apply to the employer; and

(b) Pay to the CIR an amount equal to the tax deduction that should have been made but was not.

1080.90  PAYE records [TAA, s 24]

Employers must keep a record of all PAYE income payments made to employees. The record must show, for each employee, the gross (pre-tax) amount of the PAYE income payment and the amount of tax (if any) deducted from it. The record must be created at the time each PAYE income payment is made.

If the employer uses a PAYE intermediary, the employer is only required to record the gross payment of salary or wages in respect of each employee [see 1090 PAYE INTERMEDIARIES].

The employer or PAYE intermediary must take all reasonable precautions for the safe custody of all PAYE records, including pay sheets, receipts for PAYE income payments, withholding certificates, tax code notifications, tax code certificates, and certificates of entitlement. These records must be kept for at least seven years after the payments, to which they relate, were made.

1080.95  Employer monthly schedules [TAA, ss 36A, 36B, 36C, 36D, 36E; s YA 1]

An “employer monthly schedule” is a form that an employer or a PAYE intermediary, who withholds tax from a PAYE income payment, must provide to Inland Revenue each month under s RD 22. The employer monthly schedule must be filed electronically, in the format prescribed by the CIR. However, the requirement to file electronically does not apply if the employer:

(a) Is not a new employer and has gross amounts of tax for PAYE income payments and employer’s superannuation contributions for the preceding tax year of less than $100,000;

(b) Is a new employer, but only in relation to the months in the income year for which the total amounts of tax for PAYE income payments and employer’s superannuation contributions remain under $100,000; or

(c) Is authorised under s 36B of the TAA to provide the schedule in a non-electronic format (see below).

An “employer monthly schedule” must contain the following information for the month to which the schedule relates:

(a) The employer’s name and tax file number;

(b) The name of every person who was an employee at any time during the period to which the schedule relates;

(c) The tax file number of each employee, if supplied;

(d) The tax code of each employee to whom a PAYE income payment (other than an extra pay) is made;

(e) The amount of gross earnings, the total amount of tax withheld, the total amount of tax credits for payroll donations, and the amount of earnings not liable to the earner levy, for each employee;

(f) Particulars of child support and student loan deductions made, if applicable;

(g) The amount of KiwiSaver contribution deductions made, if applicable, for each employee;

(h) The amount of employer’s superannuation cash contributions (net of ESCT), if applicable, for each employee;

(i) The date on which a new employee commenced employment;

(j) The date on which an employee who left ceased employment;

(k) The identity of each employee who received an extra pay at a rate less than 38 per cent (from 1 April 2009); and
(l) Other particulars required by the CIR for a class of employer [s YA 1].

Inland Revenue may authorise an employer, who would otherwise be required to file an employer monthly schedule electronically, to furnish it in a non-electronic format (ie on a printed form) if the cost likely to be incurred by the employer in furnishing it electronically is material [TAA, s 36B].

An employer who is not required to file the employer monthly schedule electronically may elect to do so [TAA, s 36E].

If an employer employs a school student whose total annual earnings from employment are not expected to exceed $2,340, the student does not have to be included on the employer monthly schedule since no tax is required to be deducted from their earnings [see 1080.63].

1080.97 PAYE payment form [TAA, ss 24J, 36A; s YA 1]

A PAYE payment form must accompany each payment of tax deductions to Inland Revenue. The PAYE payment form is referred to by Inland Revenue as the employer deductions form (IR345).

A “PAYE income payment form” must contain the following information for the PAYE period to which it relates:

(a) The period to which the form relates;
(b) The name of the employer;
(c) The tax file number of the employer;
(d) The total amount of tax withheld and paid;
(e) The total child support payments;
(f) The total student loan payments;
(g) The total KiwiSaver contribution payments;
(h) The amount of employer’s superannuation contributions paid under the KiwiSaver Act 2006 and the amount of ESCT withheld and paid;
(i) The amount of employer’s superannuation contributions paid and the amounts of tax withheld and paid [other than that shown in item (h)]; and
(j) Any similar information the CIR requires [s YA 1].

Employers can choose whether to furnish PAYE payment forms electronically or non-electronically. When information is furnished electronically, it must be furnished in a format prescribed by the CIR. The CIR must prescribe suitable electronic formats for furnishing PAYE payment forms electronically.

1080.99 Ceasing business or ceasing to employ

When an employer ceases, or is about to cease, to carry on business, Inland Revenue must be informed by phone or by way of a business cessation form (IR315). The employer must complete an employer monthly schedule (IR348), showing the date each employee stopped work, by the 20th of the month following the month in which business ceased. An employer deductions form (IR345) will also be required for the final month.

If the employer permanently stops employing staff permanently, but does not cease business, an employer monthly schedule must be completed for the month in which employment ceased.

1080.105 Employer’s superannuation contribution tax (ESCT) [ss RA 5, RD 64, RD 65]

An employer or a PAYE intermediary who makes an employer’s superannuation cash contribution must deduct employer’s superannuation contribution tax (ESCT) from it and pay the ESCT to the CIR by the due date [ss BE 1(5), RA 5]. An “employer’s superannuation cash contribution” is a contribution paid in money by an employer to either a superannuation fund or, under the KiwiSaver Act 2006, to the CIR for later payment to a superannuation fund, where the contribution is for the benefit of an employee [s RD 65(1)]. The rates of ESCT are set out in 1390.105.
Example:
An employer contributes an amount equal to 10 per cent of an employee’s salary to a superannuation fund (which is not a KiwiSaver scheme or a complying superannuation fund) on behalf of the employee each month. The employee’s monthly salary is $4,000. The employer makes a specified superannuation contribution of $400 each month. Assuming the applicable rate is 33 per cent, the employer is required to withhold 33 per cent of the contribution ($132) and pay it to Inland Revenue. The balance of $268 ($400 − $132) is paid to the superannuation fund.

Prior to 1 April 2012, compulsory employer contributions (ie not exceeding two per cent of the gross salary or wage payment) to KiwiSaver schemes and complying superannuation funds are not subject to ESCT [s RD 65(4)]. See 860.87.

Non-monetary contributions by employers to employee superannuation schemes are subject to FBT, not ESCT [see 540.175].

1080.106 Employer fails to deduct ESCT [s RD 70]
If an employer or a PAYE intermediary fails to withhold employer’s superannuation contribution tax (ESCT) from an employer’s superannuation cash contribution, the employer is liable to pay to the CIR an amount calculated using the following formula:

\[
\text{(tax rate / 1 – tax rate)} \times \text{contribution to fund} – \text{tax already paid}
\]

Where:
“Tax rate” is the applicable rate of ESCT;
“Contribution to fund” is the amount of the contribution (excluding tax) received by the superannuation fund;
“Tax already paid” is the amount (if any) of ESCT already paid for the contribution.

The effect of this calculation is that the amount of the employer contribution paid to the superannuation fund is treated as the net amount, and the ESCT is calculated on the grossed up amount of the contribution.

Example:
An employer makes an employer’s superannuation contribution of $1,000 to a superannuation fund (which is not a KiwiSaver scheme or a complying superannuation fund) on behalf of one of its employees. The employer does not deduct ESCT from this payment. The superannuation fund therefore actually receives $1,000. Assuming that the applicable ESCT rate is 33 per cent, the employer has an ESCT liability of $492.54, calculated as follows:

\[
0.33 \div (1 - 0.33) \times \$1,000 - 0 = \$492.54
\]

The gross amount of the contribution is thus deemed to have been $1,492.54 ($1,000 + $492.54), and ESCT on this at the rate of 33 per cent would be $492.54.

ESCT must be paid to Inland Revenue by the same due dates as apply for PAYE deductions [see 1080.80 to 1080.82].

1080.110 Recovery of unpaid tax deductions [TAA, ss 167, 168, 169]
Tax and earner-related payments withheld or deducted by employers and PAYE intermediaries under the PAYE rules (including earner levies) are deemed to be held by the employer in trust for the Crown. Legally, they are not the property of the employer. If an employer is made bankrupt or liquidated, or if an assignment is made for the benefit of the employer’s creditors, the amounts withheld or deducted do not form part of the estate available for distribution to creditors. If an employer fails to account for a tax deduction made under the PAYE rules, s 167(2) of the TAA sets the priority of the unpaid amounts if the employer is bankrupted, makes an assignment for the benefit of creditors, is liquidated, or placed in receivership. This applies notwithstanding anything in any other Act, including s 308 of the Companies Act 1993. For these purposes, “tax deduction” and “earner-related payment” do not include any late payment or shortfall penalties [TAA, s 167].

If an employer or a PAYE intermediary acting for an employer fails to withhold or deduct tax or earner-related payments as required under the PAYE rules or earner levies, the amount that should have been deducted is a debt payable to the CIR on the date the deduction should originally have been paid. The CIR may recover the outstanding amount from the employer or the employee, or partly from each [TAA, s 168].
If an employer or a PAYE intermediary acting for an employer fails, wholly or partly, to withhold or deduct tax or earner-related payment or to pay any amount to the CIR under the PAYE rules, the unpaid amount (including late payment penalties, shortfall penalties, and any costs, fees, expenses or other amount payable by the employer to the CIR in respect of any court judgment) is a charge on all the real and personal property of the employer. Special rules govern the registration, priority, operation and enforcement of the charge [TAA, s 169].

Failure to deduct tax when required to do so by a tax law may give rise to a penalty under s 143A or s 143B of the TAA, and UOMI will apply to any tax deductions paid after the due date.

In TRA Case G81 (1985) 7 NZTC 1,373, an employee who had management and control of a company in liquidation was held liable to account for the PAYE deducted by the company but not paid to Inland Revenue.

In TRA Case J12 (1987) 9 NZTC 1,071, it was held that the legislation clearly places the duty of payment of PAYE primarily on the employer, not the employee. Where the employer failed to make a tax deduction, the employee would become liable to pay the amount that should have been made by the employer. The TRA has no jurisdiction to interfere with Inland Revenue’s mode of collection.

In TRA Case K67 (1988) 10 NZTC 536, a PAYE deduction liability was imposed on a company which, to avoid “union problems”, had purportedly entered into a partnership with its workers. On the facts, it was held that the company controlled the nature of work carried out to such an extent that the agreements were a facade, and the true relationship with the company workers was employer/employee.

In TRA Case R23 (1994) 16 NZTC 6,108, a charitable trust which engaged the services of 12 previously unemployed workers under a special Employment Service work scheme to carry out restoration work on an old ship, was held to be their employer and liable to deduct PAYE and ACC levies from their wages even though the work was funded by a subsidy from the Employment Service.

Examples of situations in which shortfall penalties may, or may not, be imposed on employers that fail to deduct or account for PAYE are set out in TIB vol 12:5 (May 2000) at 51-53.

1080.115 Penalties

Employers who fail to fulfil their PAYE and related obligations may become liable to a range of penalties, some of them quite severe (eg a fine of up to $50,000 and/or prison for up to five years, for evasion). Use of money interest (UOMI) will also apply to any under or overpayment of tax deductions [see 1110 PENALTIES AND INTEREST].
An employer can transfer their PAYE and employer’s superannuation contribution tax (ESCT) obligations to a person approved as a PAYE intermediary or a listed PAYE intermediary. This PAYE intermediary or listed PAYE intermediary must:

(a) Withhold and pay to the CIR tax payable under the PAYE rules and ESCT rules; and
(b) File a return of income relating to the payment and the amount of tax.

When a person ceases to be a PAYE intermediary or a listed PAYE intermediary for an employer, the person retains the rights and obligations of a PAYE intermediary or listed PAYE intermediary, as applicable, in relation to funds that the employer has paid to the person as intermediary and that the person holds at the time they stop being an intermediary.

An employer who wishes to enter an arrangement with a PAYE intermediary must notify the CIR of the proposed arrangement, and provide the following information:

(a) The name of the PAYE intermediary;
(b) The period for which the PAYE intermediary is to act for the employer;
(c) The bank account number of the PAYE intermediary, into which the employer will deposit amounts; and
(d) Whether the proposed arrangement requires the PAYE intermediary to collect amounts under the ESCT rules.

On approval of the arrangement, the CIR must notify the employer. The approval applies to pay periods that begin on or after 14 days after the date the notice is given. An employer or a PAYE intermediary may end the arrangement by notifying the other party and the CIR. The notice must state the date that the arrangement ends, which must be after the date of notification.
An employer or a listed PAYE intermediary may end an arrangement by notifying the other party and the CIR. The notice must state the date on which the arrangement is to end, which must be on or after 14 days after the date on which the notice is given.

1090.25 **Responsibilities of employers** [ss RP 7, RP 8]

When an employer who meets the requirements of ss RP 8 to RP 11 arranges to transfer their PAYE obligations in relation to an employee and a pay period to a PAYE intermediary, the employer is not liable under the PAYE rules in relation to the employee and the pay period. However, the employer remains liable for the employee’s salary or wages for the pay period.

If the PAYE intermediary assumes the employer’s obligations under the ESCT rules, the employer is not liable under the ESCT rules in relation to the employee and the pay period. However, the employer remains liable for the payment to the employee of the employer’s superannuation cash contribution on the employee’s behalf. An employer must:

(a) Keep a record of the gross salary or wages of an employee for the pay period, the amounts of tax withheld by the employer for the pay period, the amount of any payroll donations for the pay period, and the amount of any tax credits for the payroll donations; and

(b) Provide information a PAYE intermediary requires in the time agreed by the employer and PAYE intermediary.

1090.30 **Transfers from accounts** [ss RP 9, RP 10, RP 11]

When an employer has authorised the PAYE intermediary to direct the transfer of an amount from the employer’s bank account to meet an obligation that the PAYE intermediary has on the employer’s behalf, the employer must ensure, at a time fixed by the PAYE intermediary, that the bank account has sufficient funds available for the transfer.

If an employer has not authorised a PAYE intermediary to direct the transfer of funds as described above, and the employer pays salary or wages directly to an employee for a pay period, the employer must pay the amount of tax for the payment required under the PAYE rules and ESCT rules into the PAYE intermediary’s trust account.

If the employer has not authorised the PAYE intermediary to direct the transfer of funds as described above, and the employer does not pay salary or wages directly to an employee as above, the employer must pay the amount of the employee’s gross salary or wages for the pay period into the PAYE intermediary’s trust account. However, the employer may retain an amount lawfully owed to them by the employee before making the payment.

If a PAYE intermediary has assumed the obligations of an employer under the ESCT rules in relation to an employee and a pay period, the employer must pay the amount of the employer’s superannuation cash contribution made in the pay period on behalf of the employee into the PAYE intermediary’s trust account.

1090.35 **Payments made directly by employer to employees** [s RP 12]

An employer may pay an employee’s salary or wages directly to the employee in the following circumstances:

(a) The payment is made on a day in a pay period that is not the usual day for a payment of salary or wages for the pay period;

(b) The payment is:

(i) An advance of the employee’s salary or wages;

(ii) Salary or wages owed to the employee for an earlier pay period;

(iii) A payment on the termination of the employee’s employment;

(c) The employer withholds the amount of tax that would be required under the PAYE rules and the ESCT rules if the employer did not have an arrangement with a PAYE intermediary; and

(d) The employer pays the amount referred to in item (c), in the way described in 1090.30.
1090.40 Fitness requirement [TAA, ss 15F, 15I]
A person who meets the “fitness” requirements set out below may apply to the CIR for approval to become a PAYE intermediary. A PAYE intermediary may apply to the CIR to become a listed PAYE intermediary. To make an application, the PAYE intermediary must meet, on a continuing basis, the requirements for a PAYE intermediary.

To be eligible to apply to become a PAYE intermediary, the following persons must meet a “fitness” requirement:

(a) An applicant who is a natural person or a corporation sole;
(b) Each member of an applicant that is an unincorporated body;
(c) An officer of an applicant that is a body corporate;
(d) A principal of an applicant.

Each person listed in (a) to (d) above must:

(a) Not be a discharged or undischarged bankrupt; or
(b) Not have been convicted of an offence involving fraud; or
(c) Be eligible to be a company director [TAA, s 15I].

1090.45 Application for approval as PAYE intermediary [TAA, s 15D]

To become a PAYE intermediary, a person must:

(a) Meet the above fitness requirement;
(b) Establish a trust account that meets the requirements of s RP 6 [see 1090.75]; and
(c) Operate systems to protect the personal information and payment details obtained in the course of running the account.

The CIR may approve an application if satisfied that the applicant will comply with the PAYE rules and ESCT rules, if the applicant assumes an employer’s obligations under those rules. The CIR must also be satisfied that the applicant has systems that allow them to make payments and provide information in the format required by the CIR. The CIR may approve a person as a PAYE intermediary for a set period.

1090.50 Revocation of approval as PAYE intermediary [TAA, s 15E]

The CIR may revoke an approval if the person:

(a) Does not comply with the PAYE rules;
(b) Does not comply with the ESCT rules, when they have assumed an employer’s obligations under those rules;
(c) Is no longer fit to be a PAYE intermediary because they do not meet the fitness requirements;
(d) When not a natural person, has been put into liquidation or receivership;
(e) When they are a company, is no longer registered in New Zealand.

If the CIR revokes an approval under (b) the CIR must notify the person, and any employer for whom the person remains a PAYE intermediary, of the revocation and its effective date. The effective date must be at least 14 days after the date of notification. A decision by the CIR to revoke an approval is not open to challenge.

1090.55 Listed PAYE intermediaries [s RP 3]

For a period in which a person remains a listed PAYE intermediary, they must:

(a) Continue to qualify under s 15D of the TAA as a PAYE intermediary;
(b) Meet all the obligations under Subpart RP of a PAYE intermediary;
(c) Continue to meet the fitness requirements; and
Operate technology systems that enable them to return electronically a subsidy claim form that contains a correct calculation of the amount of a subsidy under s RP 5 and s 15P of the TAA.

**1090.60 Application for approval as listed PAYE intermediary** [TAA, s 15G]

To become a listed PAYE intermediary, a PAYE intermediary must:

(a) Meet the requirements to become a PAYE intermediary [see 1090.40, 1090.45];
(b) Have completed and filed the returns of income required from them; and
(c) Have paid the required amounts of tax due from them.

A person can be a listed PAYE intermediary only if they are a PAYE intermediary. On approval of an application and before acting as a listed PAYE intermediary for an employer, the listed PAYE intermediary must inform an employer who contracts their services as a listed PAYE intermediary that the CIR does not guarantee payment by the intermediary to an employee of the employer, or the performance of a service provided by them. The CIR may approve a PAYE intermediary as a listed PAYE intermediary for a set period.

**1090.65 Revocation of approval as listed PAYE intermediary** [TAA, ss 15H, 15I]

The CIR may revoke the listing of a listed PAYE intermediary if:

(a) An approval of the person as PAYE intermediary is revoked;
(b) The person no longer meets the fitness requirements;
(c) The person does not provide a subsidy claim form by the date and in the format required by the CIR;
(d) The person does not comply with an obligation of a listed PAYE intermediary;
(e) The CIR considers revocation is necessary to protect the integrity of the tax system.

The CIR must notify a listed PAYE intermediary of an intended revocation and provide reasons for it. If the listed PAYE intermediary does not resolve the matters set out in the notice to the satisfaction of the CIR within 30 days, the CIR may give 14 days notice of revocation. At the end of the 14-day notice period the listing is revoked. A decision by the CIR to revoke an approval is not open to challenge under Part 8A of the TAA.

**1090.70 PAYE intermediaries’ responsibilities** [ss RP 13, RP 14, RP 15, RP 16; TAA, ss 15K, 15L]

A PAYE intermediary who assumes the PAYE and ESCT obligations in relation to an employee and a pay period does not become liable as an employer for the payment to the employee of the salary or wages for the pay period, or for the payment of an employer’s superannuation cash contribution made on behalf of the employee.

A PAYE intermediary must:

(a) Calculate and withhold the amount of tax for a payment of salary or wages, and pay the amount to the CIR by electronic means and in the format required;
(b) Transfer the amount of any payroll donation to the relevant recipient within the period described in s 24Q of the TAA [see 1395.77];
(c) Provide an employer monthly schedule to the CIR by electronic means and in the format required;
(d) Provide a PAYE income payment form to the CIR if required; and
(e) Keep the records referred to in s 24 of the TAA [see 1210.30].

The PAYE intermediary may make an amended monthly schedule relating to the employee and a pay period, but is responsible for the accuracy of the amendments.
PAYE Intermediaries

A PAYE intermediary who is authorised to act for an employer must direct that, at or before the time of the transfer of the payment of salary or wages, an amount equal to the amount of tax required under the PAYE and ESCT rules is transferred to:

(a) The CIR; or
(b) The PAYE intermediary’s trust account.

When a PAYE intermediary assumes the obligations of an employer under the ESCT rules, the intermediary assumes the obligations that the employer would have in the absence of s RP 2(1). The PAYE intermediary must operate and maintain systems to protect the personal information and payment details that they acquire in running the systems.

1090.75 Operation of PAYE intermediaries’ trust accounts [ss RM 7, RP 6]

A PAYE intermediary’s trust account must be named as a trust account and established at a registered bank. Deposits to the account consist of:

(a) A payment of gross salary or wages paid by an employer;
(b) An amount of employer’s superannuation cash contribution paid by an employer;
(c) An amount of tax for a payment of salary or wages required under the PAYE rules and ESCT rules, or made under s RP 12 [see 1090.35];
(d) An amount of a refund made by the CIR under s RM 7 (see below); and
(e) Interest on the amount of the funds in the trust account.

Withdrawals from the account consist of:

(a) A payment of net salary or wages to an employee;
(b) An amount of employer’s superannuation cash contribution paid by an employer;
(c) An amount of tax for a payment of salary or wages withheld under s RP 12;
(d) A payment that an employer would be required to make but for the arrangement with the PAYE intermediary, in relation to an amount of tax for a payment of salary or wages to an employee or an employer’s superannuation cash contribution made on behalf of an employee; and
(e) Interest on the amount of the funds in the trust account.

A payment relating to an employee that is credited to the trust account of a PAYE intermediary is held by the PAYE intermediary on trust for the benefit of the employee and the CIR according to their respective rights and obligations. Interest earned in the trust account of a PAYE intermediary by a payment that relates to an employee is held beneficially by the PAYE intermediary.

The CIR must refund an amount of tax for a PAYE income payment to a PAYE intermediary if the intermediary has paid the tax to the CIR for an employer:

(a) Relying on a payment made to the intermediary’s trust account:
   (i) By the employer and later dishonoured; or
   (ii) Mistakenly by a person and later recovered from the intermediary; or
(b) Mistakenly from funds not provided by the employer for a purpose related to the PAYE income payment [s RM 7].

1090.80 Payment of payroll subsidies to PAYE intermediaries [s RP 4]

The CIR may pay a subsidy to a listed PAYE intermediary for a payroll service they provide to an employer who qualifies for the subsidy if the listed PAYE intermediary:

(a) Has a contract with the employer to provide the services;
(b) Has met their obligations under ss RP 13 to RP 16; and
(c) Files a correct subsidy claim form under s 15M of the TAA.
If a subsidy is paid to a listed PAYE intermediary, the CIR must notify the intermediary of the following within 14 days of the date of payment:

(a) The amount of the subsidy paid for each employer;
(b) The period to which the subsidy relates; and
(c) Other information relevant to the payroll services provided.

The listed PAYE intermediary must calculate the amount of the subsidy in the manner provided by regulations made under this section.

The CIR must pay the amount of the subsidy within 30 days of receiving the last of:

(a) The employer monthly schedule to which the subsidy claim form relates;
(b) The payment of the tax for a PAYE income payment to which the subsidy claim form relates; and
(c) The subsidy claim form.

The CIR must pay the subsidy to a bank account nominated by the listed PAYE intermediary for the purpose or, if an overpayment has been made to the listed PAYE intermediary, to the listed PAYE intermediary’s bank account. The amount of the subsidy per employee is prescribed by the Governor-General, by Order in Council. The Governor-General may from time to time by Order in Council prescribe the amount of the subsidy.

1090.85 Subsidy claims [s RP 5; TAA, s 15M]

A listed PAYE intermediary must file a subsidy claim form within one month of the date of filing an employer monthly schedule to which the form relates. For the purposes of s 22 of the TAA [see 1210.10, 1210.30] a listed PAYE intermediary must keep the necessary records to verify the information in a subsidy claim form [TAA, s 15M].

A “subsidy claim form” means a form that a listed PAYE intermediary must provide to the CIR in an electronic format showing:

(a) The tax file number of the listed PAYE intermediary;
(b) The tax file number and name of each employer for which a subsidy is claimed;
(c) The tax file number and name of each employee of each employer in relation to whom a subsidy is claimed;
(d) The period to which the form relates;
(e) The number of PAYE income payments made by the listed PAYE intermediary to each employee in the period to which the form relates; and
(f) The amount of subsidy that the listed PAYE intermediary claims in respect of the period to which the form relates [s YA 1].
The CIR may amend the details in a subsidy claim form to correct an error. The amendment must be made within two years of receiving the form. The CIR must give the listed PAYE intermediary 14 days notice of a proposed amendment.

When a listed PAYE intermediary files a subsidy claim form and the CIR amends the details to correct an error:

(a) If an overpayment or underpayment results from the amendment, the intermediary or CIR, as applicable, must pay the amount overpaid or underpaid within 30 days of the date of notice; or

(b) The CIR may choose to use the amount of an overpayment resulting from an amendment to pay a subsidy claim made after the end of the 14-day period [s RP 5].
Chapter 1100
Payment and Collection of Tax

1100.10 Inland Revenue’s accounting system

Taxpayers who have correctly self-assessed their tax liability will receive a return acknowledgement notice from Inland Revenue within 10 weeks. This will confirm that the self-assessment was correct and will show the refund amount or the amount of tax to pay. If Inland Revenue has amended the details in the return, Inland Revenue will send the taxpayer a notice of assessment. This will show any refund or tax to pay.

Inland Revenue issues a statement of account:
(a) When tax is debited to a taxpayer’s account; and
(b) As a reminder if tax becomes overdue.

Separate accounts are kept for the various taxes imposed. These statements show:
(a) All ledger entries since the previous statement was issued, if the balance on that statement was not paid in one sum;
(b) All tax assessed as the case may be or payable at the date of issue; and
(c) An explanation of the more common entries by the use of codes or a narration typed on the statement.

Tax assessed is debited to the account and tax paid is credited. Each entry is identified by date and batch number. Payments of tax are credited to the earliest tax owing on the statement.

1100.13 Tax payment dates

[ss RA 3, RA 13, RB 1, RC 6, YA 1, sch 3; GSTA, s 23]

Tax payments must be made on or before the due date specified in the relevant legislation. If a due date falls on a weekend or public holiday, the payment will be accepted as being on time if it is posted, electronically paid, or handed in to Inland Revenue on the next business day (see details of Inland Revenue practice below).

GST payments are due on the 28th of the month following the end of the taxable period, except in the following cases:
(a) If the taxable period ends in March, payment is due by 7 May; or
(b) If the taxable period ends in November, payment is due by 15 January.

If the due date falls on a weekend or public holiday, the GST payment can be made on the next business day.

Example:
An income tax or GST payment which is due on a Saturday or Sunday will be accepted as paid on time if it is mailed and postmarked on the following Monday (assuming Monday is a business day).

Standard practice statement SPS 07/01 [see TIB vol 19:2 (March 2007)], which applies from 12 February 2007, sets out Inland Revenue’s practice for accepting tax payments as having been made on time.

1) Payments by post

Payments by post are accepted as received in time if mailed and postmarked on or before the due date. For rural delivery taxpayers, the date of payment is when it is received by New Zealand Post or a similar provider, not when the payment is placed in the taxpayer’s personal mailbox for collection.
(2) **Payments posted overseas**
Overseas postmarks cannot be used to determine the date a payment was received by Inland Revenue. Where payments are posted overseas, the date of payment is when Inland Revenue actually receives it.

(3) **Electronic payments**
Payments made electronically are accepted as received in time when actually paid or direct credited into an Inland Revenue bank account on or before the due date. Internet payments must be completed prior to the end of the bank’s online business hours to be recorded as received on a specific day. Internet payments made after those online business hours are processed on the next business day. If the payment is being made from overseas, it is made on time when electronically paid or direct credited into an Inland Revenue bank account on or before the New Zealand due date.

(4) **Physical delivery**
A payment is accepted as being received in time if deposited into an Inland Revenue drop box by the close of business on the due date.

(5) **Westpac payments**
Payments are also received in time if physically handed in to a Westpac bank branch (either over the counter or via a drop box), by the close of business on the due date.

(6) **Postdated cheques**
Inland Revenue does not bank postdated cheques until the date specified on the cheque. A cheque that is postdated after the due date, even though received on or before the due date, will thus be treated as late. This applies to cheques that are posted or physically delivered.

(7) **Weekends and public holidays**
If a due date falls on a weekend or public holiday (including a provincial anniversary day), Inland Revenue will accept a payment as in time if it is physically delivered or posted on the next working day. An electronic payment will be accepted as on time if it is credited to an Inland Revenue bank account on the next working day. This applies to all tax types, including GST and child support payments.

(8) **Tax pooling**
The date of payment is when the intermediary makes the tax payment to Inland Revenue [see 1150.77 and TIB vol 15:5 (May 2003) at 64-67].

(9) **Tax transfers**
The payment is treated as made on the effective date of the transfer [see 1215 REFUNDS AND TRANSFER OF EXCESS TAX, TIB vol 14:11 (November 2002) at 35-48, TIB vol 16:1 (February 2004) at 101-105].

1100.15 **Free postage for business tax payments**
Businesses can send their GST, PAYE and fringe benefit tax payments post free to Inland Revenue. Reply paid envelopes will be provided for this purpose. This concession is intended to simplify the tax system and reduce compliance costs [Ministerial Media Release Minister of Revenue, 2 December 2003].

1100.17 **Payment by credit card** [TAA, s 226C]
The CIR may offer to taxpayers the ability to pay their tax and other debts by credit or debit card, either by telephone or internet. The fee for making payments in this way is 1.42 per cent of the amount.

1100.20 **Tax recovery deduction notices for defaulting taxpayers** [TAA, ss 157, 157A]
Where a taxpayer has defaulted in the payment of income tax, interest under Part 7 of the TAA, or a civil penalty, the CIR may send written notice (commonly referred to as an “attachment notice”), requiring a person to deduct from any amount payable (or to become payable) to the defaulting taxpayer, an amount and
pay it to Inland Revenue within a specified time. The notice may specify the deductions be made in instalments. The notice may also specify a daily amount of interest which accumulates on the overdue tax and penalties between the date of issue of the notice and the date the amount specified in the notice is finally deducted. It applies to money on deposit, whether in ordinary savings accounts, term or fixed deposit accounts, or any other savings accounts in Postbank Ltd, trustee savings banks, private savings banks, building society savings banks, and to cheque accounts in trading and savings banks. It also applies to money paid to the CIR by a tax pooling intermediary.

Money held in joint bank accounts can (from 21 December 2010) be recovered by the CIR under s 157 if the taxpayer is able to withdraw money from the account without a signature or authorisation (such as pin number) from the other account holders. This does not apply to the joint bank accounts of partnerships that file annual returns of income under s 33(1) of the TAA.

The following types of accounts are specifically excluded from these attachment provisions:
(a) A Home Lay-by Account within the meaning of the Post Office Act 1959;
(b) A Home Ownership Account within the meaning of the Home Ownership Savings Act 1974;
(c) A Farm Ownership Account within the meaning of the Farm Ownership Savings Act 1974; and
(d) A Fishing Vessel Ownership Account within the meaning of the Fishing Vessel Ownership Savings Act 1977.

Any person required to make deductions does so as the agent of the taxpayer and is indemnified for the deductions. Tax deduction notices may also be issued against salary and wages. The maximum amount to be deducted is the greater of the amounts in (a) or (b) below:

(a) The lesser of:
   (i) 10 per cent per week of the income tax due and payable; or
   (ii) 20 per cent of the gross wages or salary payable; and
(b) Ten dollars per week.

The deduction notices may be attached for the recovery of income tax, PAYE deductions in their various forms, earner levies, amounts paid to a tax pooling intermediary, unpaid tax under a tax recovery agreement, employer’s superannuation contribution payments, and employer and employee KiwiSaver contributions. Where a notice is issued to a person or financial institution the CIR is required to issue a copy of the notice to the taxpayer. When a request is made to a bank all moneys deposited in the taxpayer’s accounts with the bank subsequent to the issue of the notice, as well as the balance of the accounts, must be paid to the CIR until the amount specified in the notice is satisfied or the notice revoked [see 1100.22].

Any notice given may at any time be revoked by the CIR by a subsequent notice. The notice must be revoked at the request of the taxpayer when the CIR is satisfied that:
(a) All income tax then due and payable by the taxpayer has been paid; and
(b) A sum is held to the credit of the taxpayer of not less than the income tax due for the then current tax year.

A person who has had any deduction on account of income tax payments made from any amounts is entitled to receive a written statement of the deduction and the purpose for which it was made from the person making the deduction.

The amounts deducted under these provisions are deemed to be held in trust for the Crown and, without prejudice to any other remedies available, are recoverable in the same manner as if they were income tax payable by the employer or other person required to make the deduction. Tax arrears deducted from wages must be accounted for to Inland Revenue separately from current PAYE deductions.

The section applies only to “any amount payable or to become payable” to the taxpayer. It cannot be applied where the taxpayer has lost the right to receive moneys, whether or not due to a voluntary act on the taxpayer’s part (eg an assignment under a deed of arrangement with creditors).
Payment and Collection of Tax

When a person (other than an employer) receives a notice from the CIR requiring them to deduct an amount from payments to a taxpayer and fails to comply with the notice, that person is liable to prosecution for an offence but is not liable to pay interest or civil penalties [TAA, s 157A]. This provision only applies to notices issued under:

(a) Section 157 of the TAA;
(b) Section 43 of the GSTA 1985;
(c) Section 154 of the Child Support Act 1991;
(d) Section 46 of the Student Loan Scheme Act 1992; or
(e) Another tax law specifying obligations in relation to withholdings or deductions of tax that operates by reference to s 157 of the TAA.

The validity of an attachment notice was challenged in *Anzamco Ltd (in liq) v Bank of New Zealand* (1982) 5 NZTC 61,249 (HC). Anzamco sought an application for review of one of the attachment notices. In that case the applicant acquired two large farming properties, which were sold in 1980. The CIR considered the sale gave rise to a taxable profit and reissued an assessment accordingly. The company went into liquidation in December 1981. In March 1982 the liquidator placed $935,000 of the company’s funds on term deposit. The manager of the bank was served with an attachment notice requiring a deduction of $629,333 from the money held on the applicants’ behalf. The application was allowed on the grounds that the form of the notice did not comply with the clear wording of the section. As a result, it was invalid. Since an attachment notice interferes with the rights of the subject the legislation authorising it must be followed exactly.

In *King v Leary* (1988) 10 NZTC 5,067 (HC), a notice was served on a solicitor for tax payable by his client. When instructions were received by the solicitor as trustee of a family trust to pay funds to his client as beneficiary, the solicitor was bound to comply with deduction requirements of the notice.

A notice issued by the CIR under s 157 of the TAA for the police to hand over cash seized from a suspected drug dealer was not invalidated by the fact that the police had obtained the cash during an unlawful search, provided the CIR fully complied with s 157 of the TAA in issuing the notice: *Wojcik v Police* (1996) 17 NZTC 12,646 (DC).

In *Singh v Commissioner of Inland Revenue* (1999) 19 NZTC 15,050 (HC), the CIR was entitled to postpone the repayment of funds seized under s 400 of the ITA 1976 (the predecessor to s 157 of the TAA) until such time as an investigation to quantify the actual amount of tax payable had been completed. The CIR could point to a set of circumstances that justified the proper retention of the funds. Laurenson J, citing *Commissioner of Inland Revenue v Wilson* (1996) 17 NZTC 12,512 (CA) and *Poananga v State Services Commission* [1985] 2 NZLR 385 (CA), observed that it would have been an abuse of the CIR’s powers if the substantial purpose of the decision to refuse repayment was to enable the Court to determine the ownership of the funds.

An attachment notice issued under s 157 of the TAA will be effective even if the income tax assessment to which the unpaid tax relates has been challenged and the challenge is not yet resolved, to the extent of any non-deferrable tax (arising under s 138I), that has not been paid by the taxpayer: *Hieber v Commissioner of Inland Revenue* [2000] 3 NZLR 718, (2000) 19 NZTC 15,716 (HC). Non-deferrable tax is the amount of tax in dispute [see 260.105].

In *Enterprises Lakeview Ltd v Commissioner of Inland Revenue* (2009) 24 NZTC 23,139 (HC) the CIR issued a deduction notice under s 157 of the TAA to Solid Energy, a debtor of the defaulting taxpayer, to recover unpaid taxes. The taxpayers referred to in the notice were a partnership (Mr and Mrs S) and a company (TFW Ltd) controlled by Mr S. The business, which involved the supply of kindling wood and trellis fencing, traded under the name of TFW Ltd. After the issue of the deduction notice, Mr S purported to transfer the business of TFW Ltd to Enterprises Lakeview Ltd (EL Ltd) and issued subsequent invoices to Solid Energy in the name of EL Ltd, in order to circumvent the deduction notice. However, Mr S retained effective control of the business. Following an investigation, Inland Revenue advised Solid Energy that in its view EL Ltd was merely an agent for the taxpayers named in the notice, and that moneys owing to EL Ltd should also be paid to Inland Revenue. EL Ltd claimed that the deduction notice could not be used against it because it was not...
the taxpayer named in the notice. The court held that the CIR acted reasonably and within his lawful powers in instructing Solid Energy to pay moneys owing to EL Ltd to the CIR. The creation of EL Ltd was a device or artifice by Mr S to avoid the implications of the deduction notice.

1100.22 Inland Revenue practice on deduction notices [TAA, s 157]


Inland Revenue will not issue a deduction notice for tax arrears that are subject to an instalment arrangement between the taxpayer and the CIR provided the arrangement is being adhered to by the taxpayer.

A deduction notice may require deductions to be made either in a lump sum (one-off notice) or by instalments (on-going notice). The bank is required to forward the deducted funds to Inland Revenue according to the date specified on the notice. If no funds are available the bank is required to advise Inland Revenue.

Inland Revenue will not require deductions from a bank account if this would put the taxpayer into, or further into, overdraft. However, if Inland Revenue issues a deduction notice for an account which is in credit and the taxpayer attempts to avoid complying with the notice by transferring funds from that account so that it will go into overdraft, then the deduction notice will take priority.

A deduction notice may require deduction from amounts held on the date of the notice, or from amounts deposited after the date of the notice. Inland Revenue is able to require daily monitoring of accounts where this is considered necessary. If daily monitoring is required, it will usually be for a maximum of 10 working days. However, Inland Revenue reserves the right to require an account to be monitored over a longer period of time.

A deduction notice may require deductions to be made to cover daily interest; in this case the rate of interest will be advised in the notice. Interest starts on the date of the deduction notice and ends on the day on which the amount required to be deducted has been deducted.

A deduction notice will continue to apply until the deduction is made by the bank (in the case of a one-off notice), until the total amount required pursuant to an on-going notice has been deducted, or until the notice is revoked or withdrawn by Inland Revenue.

With recovery of funds under the TAA, GDA, GSTA and SLSA, deductions made by the bank are held in trust for the Crown until they are forwarded to Inland Revenue. If the deduction is not made by the bank, the amount required to be deducted is recoverable by Inland Revenue from the bank as if it were tax payable by that bank.

A deduction notice issued under the TAA, GDA, GSTA and SLSA can be placed on joint bank accounts when the money is able to be withdrawn from that account by the defaulting person without the signature or other authorisation of the other joint bank account holder(s).

A deduction notice can only be placed on a partnership account in respect of the partnership’s liability as a taxpayer. A partnership account is defined in s 157(12) of the TAA as a joint account that files a return of income under s 33(1) of the TAA. A deduction notice cannot be placed on a partnership bank account to satisfy a partner’s personal tax liability.

The term “other authorisation” ensures that deduction notices can be applied to accounts which are accessed electronically.

Under s 154 of the CSA, the CIR is able to require banks to make deductions from money payable to a liable parent. Under s 155 of the CSA this deduction power extends to money held in joint bank accounts in the name of the liable parent and one or more other persons when the liable parent can draw from that account without the signature of the other person(s). Overpayments made to payees may also be recovered in the same manner as liable parent debt under s 151(2) of the CSA.
Both the primary caregiver and their partner or spouse, are jointly and severally liable for any overpayment of Working for Families tax credits. The CIR may place a deduction notice on the bank accounts of the primary caregiver and/or their spouse and any joint account held in the names of either the primary caregiver or the spouse.

A deduction notice will apply to money that is held in a term investment whether or not that investment is due to mature.

If a bank fails to make the deductions required by a deduction notice, and there was an amount payable, or an amount became payable, Inland Revenue has the power to prosecute the bank for not complying with the terms of the deduction notice under s 157A of the TAA. This does not apply to a deduction notice for child support.
# Chapter 1110

## Penalties and Interest

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### 1110.10 Due dates for paying penalties

The following table summarises the due dates for paying penalties.

<table>
<thead>
<tr>
<th>TAA Section</th>
<th>Type of payment</th>
<th>Payment due date</th>
</tr>
</thead>
<tbody>
<tr>
<td>142</td>
<td>Late filing penalty</td>
<td>Later of 30 days after notification and various dates as set out in legislation.</td>
</tr>
</tbody>
</table>
**Penalties and Interest**

<table>
<thead>
<tr>
<th><strong>TAA Section</strong></th>
<th><strong>Type of payment</strong></th>
<th><strong>Payment due date</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>142A</td>
<td>Tax that is not a penalty (if amount due on a due date is increased)</td>
<td>At least 30 days after notice of assessment or reassessment issued.</td>
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<tr>
<td>142B</td>
<td>Shortfall penalties</td>
<td>At least 30 days after notice of assessment or reassessment issued.</td>
</tr>
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<td>142C</td>
<td>Payments by officers</td>
<td>At least 30 days after notice of assessment or reassessment issued.</td>
</tr>
<tr>
<td>142D</td>
<td>Repayment of excess refund or credit of tax</td>
<td>Later of 30 days after the date of notification requiring payment or the date specified in the notice.</td>
</tr>
<tr>
<td>142E</td>
<td>Imputation penalty tax</td>
<td>20 June following the end of the imputation year.</td>
</tr>
<tr>
<td>142F</td>
<td>Deferrable tax</td>
<td>30th day after the last day of the relevant period of deferral.</td>
</tr>
<tr>
<td>142G</td>
<td>Non-electronic filing penalty</td>
<td>Fifth day of the month following the month in which the employer monthly schedule was due.</td>
</tr>
</tbody>
</table>

### 1110.15 Purposes of penalties rules [TAA, s 139]

The stated purposes of the penalties regime are:

(a) Encourage taxpayers to comply voluntarily with their tax obligations and to cooperate with Inland Revenue;

(b) Ensure that penalties for breaches of tax obligations are imposed impartially and consistently; and

(c) Sanction non-compliance with tax obligations effectively and at a level that is proportionate to the seriousness of the breach.

### 1110.20 Non-application of penalties rules [TAA, s 141JA]

The penalties rules in Part 9 of the TAA do not apply to a non-filing taxpayer if the person:

(a) Is an employee who has been required, under s RD 4(2), to provide an employer monthly schedule and pay outstanding tax deductions in respect of a PAYE income payment; and

(b) Receives an income statement [see 1270.75] that the taxpayer considers incorrect and informs the CIR as required by s 80F of the TAA.
1110.25 Application of penalties to PAYE intermediaries [TAA, s 141JB]
The late filing penalty, late payment penalty and shortfall penalties apply to a PAYE intermediary [see 1090 PAYE INTERMEDIARIES] as if the intermediary were the employer, unless the employer has failed to:
(a) Pay the gross salary or wages to the intermediary; or
(b) Provide the information required by the intermediary within the agreed time.
If the employer has failed to do either of the above, the late filing penalty, late payment penalty and shortfall penalties apply to the employer and not to the intermediary.

1110.30 Civil penalties
A civil penalty means any of the following:
(a) A late filing penalty;
(b) A late payment penalty;
(c) A shortfall penalty;
(d) A promoter penalty;
(e) A non-electronic filing penalty; or
(f) A civil penalty under ss 215 (until 31 March 2009) or 216 of the KiwiSaver Act 2006 [TAA, s 3(1)].
Civil penalties are not deductible [s DB 1].

(1) Recovery of civil penalties by the CIR [TAA, s 156A]
For the purposes of recovering unpaid civil penalties, a civil penalty is treated as a tax of the same type as the tax:
(a) For which the penalty is imposed;
(b) For which the tax return is to be provided (if the penalty is a late filing penalty); or
(c) For which the return is provided (if the penalty is a non-electronic filing penalty).

A late filing penalty relating to an overdue ACC earners’ levy reconciliation statement is treated as a tax in the nature of income tax.

A civil penalty is recoverable from a taxpayer (or PAYE intermediary, if applicable) at any time after it has become payable, whether or not the taxpayer has been convicted of an offence in relation to the act, omission or matter that gave rise to the liability for the penalty.

1110.35 Late filing penalty [TAA, ss 139A, 142, 183AA]
The late filing penalty applies to the following types of tax returns:
(a) Annual tax returns;
(b) Annual ICA returns required to be furnished by Australian ICA companies that are not required to file income tax returns;
(c) Reconciliation statements;
(d) Returns required to be furnished by portfolio tax rate entities and portfolio investor proxies under s 57B of the TAA;
(e) Employer monthly schedules.

The late filing penalty does not apply to FBT returns or, prior to 1 April 2008, GST returns.

A taxpayer is liable to pay a late filing penalty if the taxpayer fails to provide a return, statement, or schedule listed above on time. The late filing penalties are as follows:

- Annual tax return with net income below $100,000: $50
- Annual tax return with net income between $100,000 and $1,000,000: $250
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Annual tax return with net income over $1,000,000 $500
Annual ICA returns, reconciliation statements and employer monthly schedules $250

Net income is annual gross income less annual total deduction [s BC 4(2)]. Deductions include net losses incurred in the current income year, but not losses brought forward from earlier years.

The CIR must, at least 30 days before imposing a late filing penalty for any late return other than an employer monthly schedule or a GST return, either:
(a) Notify the taxpayer in writing that a late filing penalty may be imposed if the return specified in the notice is not filed; or
(b) Publicly notify that a late filing penalty may be imposed on taxpayers who do not file the required return.

1. Employer monthly schedules

Where a taxpayer fails to file an employer monthly schedule on time, the CIR must send the taxpayer a warning notice. If the taxpayer has filed on time all employer monthly schedules due in the past 12 months, except for the most recent one, the taxpayer will be notified that a late filing penalty will be payable on any further failure to file on time. If the taxpayer has not filed on time all employer monthly schedules due in the past 12 months, the CIR must notify the taxpayer that the late filing penalty is payable on the current failure to file on time.

2. GST returns [TAA, s 139AAA]

A registered person is liable to pay a late filing penalty if:
(a) The registered person has not completed and filed a GST by the due date [see 580.110];
(b) The registered person has failed to file one or more GST returns on time in the past 12 months; and
(c) The CIR notifies the registered person that the penalty is payable.

The penalty is $250 if the invoice or hybrid basis is used or $50 if the payments basis is used, to calculate the GST liability.

If the registered person has filed on time all GST returns due in the past 12 months, the CIR must notify the registered person that the late filing penalty will be payable on any future failure to file a return on time. Otherwise, the CIR must notify the registered person that the penalty is payable on the current failure to file on time.

3. Due date for paying penalty [TAA, s 142]

Except in the case of employer monthly schedules or GST returns, the due date for payment of a late filing penalty is the later of a date specified by the CIR (not less than 30 days after the day the CIR notifies the taxpayer that the penalty is payable), and:

For
Annual tax returns
ACC earner premium reconciliation statements
ACC earner premium reconciliation statement following cessation of business
Annual ICA returns required to be furnished by Australian ICA companies that are not required to file income tax returns

Applicable date
The terminal tax date for the tax year to which the annual tax return relates
31 May following the tax year to which it relates
15th of the second month after the month in which the employer ceases business
The date by which the company is required to file the annual ICA return [TAA, s 69(1), (2)(a)]

The due date for payment of a late filing penalty for an employer monthly schedule is:
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For

Employer monthly schedules for large employers [see 1080.81]
Employer monthly schedules for small employers, and for new employers whose total tax deductions have not yet reached $100,000

Applicable date

The 5th of the month following the month in which the employer monthly schedule was due
The 20th of the month following the month in which the employer monthly schedule was due

For GST returns, the due date for payment of a late filing penalty is the 28th day of the second month following the end of the taxable period, with two exceptions:
(a) If the month following the end of the taxable period is December, the penalty is due on 15 February;
(b) If the month following the end of the taxable period is April, the penalty is due on 7 June.

For useful summaries of the factors that are taken into account by the Courts when determining the level of penalty to impose for failure to file tax returns: Commissioner of Inland Revenue v Wheeler (1999) 19 NZTC 15,183 (HC), R v Donaldson (1997) 14 CRNZ 537 (CA), Commissioner of Inland Revenue v Simpson HC Auckland AP291/97, 14 January 1998 and Denver Videotronics Ltd v Commissioner of Inland Revenue (1986) 8 NZTC 5,163 (HC).

(4) Inland Revenue practice


It is Inland Revenue’s practice that the late filing penalty will be imposed on:
(a) Income tax returns for individuals and companies;
(b) Employer monthly schedules; and
(c) Annual imputation returns required to be furnished by Australian imputation credit account companies that are not required to file income tax returns.

Inland Revenue will not impose late filing penalties on ACC reconciliation statements because Inland Revenue no longer collects these statements on behalf of ACC.

The late filing penalty will be imposed on outstanding income tax returns if:
(a) The return is not filed by the due date and is not subject to an extension of time (EOT) arrangement;
(b) The return is subject to an EOT arrangement but is not filed by the date agreed in the arrangement;
(c) An EOT arrangement is withdrawn from a client of a tax agent and the return is not filed by the date specified when the EOT was withdrawn; or
(d) The return is for a client of a tax agent with an EOT arrangement and is not filed by 31 March in the year following the income year to which the return applies.

The CIR will provide written notification of at least 30 days prior to the intention to impose the late filing penalty, either by public notification or directly to the taxpayer.

The amount of the penalty is based on the previous year’s tax return. If the previous year’s return has not been filed, or Inland Revenue has no information on which to base the penalty, the minimum penalty of $50 will be imposed. The penalty will be adjusted, if necessary, after the current year’s tax return has been filed. The minimum penalty is payable even if the taxpayer has no net income for the year.

Inland Revenue has no statutory obligation to give an employer warning that a late payment penalty is to be imposed for an unfiled employer monthly schedule. However, it is Inland Revenue practice to issue a warning notice the first time an employer fails to file a schedule by due date, and advise that the late filing penalty will not be imposed if the schedule is filed immediately (the practice statement does not specify what “immediately” means).

If, within 12 months of the warning notice being issued, a further default in filing a schedule occurs, a late filing penalty will be imposed in respect of the second default, and a notice will be issued advising that the
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penalty is payable (ie no warning is given). Any default more than 12 months after the warning notice was issued is treated as a “first offence” and a new warning notice is issued.

A late filing penalty will be imposed when an annual imputation return has not been filed by the due date, and at least 30 days written notification of the intention to impose the penalty has been given, either directly to the tax payer or by public notification.

A late filing penalty may be reversed if:

(a) The return was filed before the date the penalty was imposed, but had not been “lodged” by Inland Revenue; or

(b) The return or employer monthly schedule was not required to be filed; or

(c) In respect of an employer monthly schedule, the taxpayer did not pay any salary or wages even though it was a registered employer.

A late filing penalty may be remitted if the legislative criteria contained in ss 183A and 183D of the TAA are met [see 1110.335 to 1110.345].

The late filing penalty will not be remitted if:

(a) The taxpayer has an EOT arrangement as a client of a tax agent, but the agent had not notified the CIR that the taxpayer was their client before the late filing penalty was imposed.

(b) The taxpayer was granted an EOT (either as a client of a tax agent or individually) after the late filing penalty was imposed.

The CIR must automatically remit a taxpayer’s late filing penalty to the extent to which, objectively, the penalty is imposed because of errors in respect of the change in the GST rate on 1 October 2010 (for example, where the required systems changes to accommodate the new rate have not been able to be made in time) [TAA, s 183AA].

1110.40 Late payment penalty [TAA, ss 139B, 183F]

A taxpayer is liable to pay a late payment penalty if and to the extent that the taxpayer does not pay by the due date (the “default date”) an amount of tax (the “unpaid tax”), calculated by the taxpayer as payable, or for which the taxpayer is assessed, and any one or more of the following apply:

(a) The unpaid tax is provisional tax or a penalty relating to a failure to pay provisional tax;

(b) Ignoring any failure to pay for which a penalty or interest is remitted under s 183AA of the TAA, [see 1110.350], the taxpayer has failed to pay on time an amount of tax due for payment in the period:

(i) Beginning with the day that is two years before the default date (but no earlier than 1 April 2008); and

(ii) Ending before the default date;

(c) Ignoring any failure to pay for which a penalty or interest is remitted under s 183AA of the TAA [see 1110.350]. The taxpayer has paid on time all amounts of tax due for payment in the period referred to in paragraph (b) and:

(i) The CIR gives the taxpayer a notice setting a further date for payment of the unpaid tax; and

(ii) The taxpayer does not pay the unpaid tax before the date that is the earlier of the further date and the date that is one month after the date of the notice.

A taxpayer is liable to pay a late payment penalty in relation to a default date if:

(a) The CIR has given the taxpayer a notice of a further date for the payment of unpaid tax;

(b) After giving the notice, the CIR becomes aware of a default by the taxpayer that arose before the date of the notice; and

(c) The further date for payment falls outside the two-year period referred to above and should have been given in relation to the default referred to in (b).
If a taxpayer enters into an instalment arrangement under s 177B of the TAA [see 480.30] and a late payment penalty is imposed under s 139BA(1) [see 480.50], the taxpayer is treated for the purposes of s 139B of the TAA as paying the amount of tax due for payment on time, to the extent of the default.

The late payment penalty does not apply if the amount of income tax or ancillary tax outstanding after due date is $100 or less [TAA, s 183F].

The late payment penalty consists of an initial late payment penalty and an incremental late payment penalty. The initial penalty consists of two components:

(a) One per cent of the unpaid tax, which is added to the unpaid tax on the day after the default date for the unpaid tax.

(b) Four per cent of the tax to pay at the end of the sixth day after the day on which the penalty in item (a) is imposed. This is added to the tax to pay at the end of the sixth day after the penalty in item (a) is imposed. For this purpose, “tax to pay” means the sum of the unpaid tax and the one per cent penalty imposed under item (a).

The incremental late payment penalty is one per cent of the amount of tax to pay one month after the day on which the one per cent initial late payment penalty is imposed, or the day an incremental penalty was last imposed. This is added to the tax to pay on the day after the last day of successive monthly intervals during which the tax to pay remains unpaid (see example below). If this day falls on a day that does not exist (eg 31 April), the penalty is added on the last day of the month (eg 30 April).

The four per cent initial late payment penalty will not be added if the CIR has:

(a) Exercised powers available under s 157 of the TAA or s 43 of the GSTA 1985 (or a similar provision), to recover the overdue tax from the taxpayer by attachment notice [see 1100.20 and 580.153], before the end of the sixth day after the day the one per cent initial penalty was imposed; and

(b) Received the tax withheld or deducted in accordance with the requirements of the attachment notice.

The incremental late payment penalty will not be added if, for a month during which the tax to pay remains unpaid, the CIR has:

(a) Exercised powers available under s 157 of the TAA or s 43 of the GSTA 1985 (or a similar provision), to recover the overdue tax from the taxpayer by attachment notice; and

(b) Received the tax withheld or deducted in accordance with the requirements for the month of the attachment notice.

When a taxpayer has applied for financial relief under ss 177 to 177C of the TAA, the way in which the late payment penalty is imposed is modified [see 480.50].

“Tax to pay” means (at any time) the unpaid tax together with any unpaid late payment penalty. The unpaid tax is deemed to be the last part of any tax to pay that a taxpayer pays.

“Unpaid tax” includes an amount of tax that must be withheld or deducted and paid to the CIR under a tax law, but does not include a late payment penalty or a shortfall penalty imposed under s 141ED of the TAA.

### Example

Until 18 November, Henry forgot to file his GST return and pay the GST owing on the due date of 31 August. The amount of GST due on 31 August was $1,854.32. Henry will be liable for late payment penalty as follows:

<table>
<thead>
<tr>
<th>Amount</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>GST payable 31 August (“unpaid tax”)</td>
<td>$1,854.32</td>
</tr>
<tr>
<td>1 September — 1% initial late payment penalty</td>
<td>$18.54</td>
</tr>
<tr>
<td>($1,854.32 × 1%)</td>
<td></td>
</tr>
<tr>
<td>Tax to pay</td>
<td>$1,872.86</td>
</tr>
<tr>
<td>7 September — 4% initial late payment penalty</td>
<td>$74.91</td>
</tr>
<tr>
<td>($1,872.86 × 4%)</td>
<td></td>
</tr>
<tr>
<td>Tax to pay</td>
<td>$1,947.77</td>
</tr>
<tr>
<td>1 October — 1% incremental late payment penalty</td>
<td>$19.48</td>
</tr>
</tbody>
</table>
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\[
\begin{array}{|l|}
\hline
\text{($1,947.77 \times 1\%)} \\
\text{Tax to pay} & \$1,967.25 \\
\text{1 November — 1\% incremental late payment penalty} & \$19.67 \\
\text{($1,967.25 \times 1\%)} \\
\text{Tax to pay 18 November} & \$1,986.92 \\
\text{Total penalties payable (1,986.92 – 1,854.32)} & \$132.60 \\
\hline
\end{array}
\]

The CIR is able to remit a late payment penalty in limited circumstances [see TAA, s 183A and 1110.335].

1110.45 Penalty for not paying employer monthly schedule amount [TAA, s 141ED]

A penalty is payable when a taxpayer files an employer monthly schedule with the CIR showing an amount of tax payable (the “returned amount”) but fails to pay the total amount owing by the due date [see 1080.80 to 1080.82]. The CIR must, after the due date for paying the returned amount, give the taxpayer notice (the “CIR’s notice”) of the following:

(a) That the taxpayer is liable to pay a penalty for failing to pay the unpaid amount by the due date and how the penalty is calculated;
(b) The circumstances in which further penalties will be imposed and how they will be calculated; and
(c) What action the taxpayer can take to avoid further penalties being imposed.

Before sending this notice, the CIR must first notify the taxpayer that a penalty may be imposed under s 141ED of the TAA if the unpaid amount is not paid. The penalty does not apply if:

(a) The taxpayer is a receiver or liquidator appointed after the end of the return period to which the employer monthly schedule relates, and there are insufficient funds available to pay the unpaid amount;
(b) The taxpayer is, during the period, negotiating an instalment arrangement with the CIR to pay the unpaid amount; or
(c) The taxpayer enters into an instalment arrangement (of the same type as set out in s 177B of the TAA) [see 480.30] with the CIR before the penalty date and pays the unpaid amount under the arrangement.

The due date for paying the penalty (the “penalty date”) is:

(a) The date of the CIR’s notice, if the penalty is the first penalty in relation to the returned amount; or
(b) One month after the penalty date for the preceding penalty, if (a) does not apply. If a penalty date would fall on a date that does not exist, the penalty date is the last day of the month.

The amount of the penalty is as follows:

\begin{align*}
\text{Circumstance} & & \text{Penalty} \\
\text{The taxpayer fails to enter into an instalment arrangement and fails to pay the unpaid amount, within one month after the penalty date} & & \text{Ten per cent of the unpaid amount on the day before the penalty date} \\
\text{The taxpayer enters into an instalment arrangement before the penalty date but fails to comply with the arrangement within one month after the penalty date} & & \text{Ten per cent of the unpaid amount on the day before the penalty date} \\
\text{The taxpayer pays the unpaid amount or enters into an instalment arrangement within one month after the penalty date, and the previous circumstance does not apply} & & \text{Five per cent of the unpaid amount on the day before the penalty date}
\end{align*}
If the returned amount is varied or corrected by the taxpayer or the CIR in the period between the date the employer monthly schedule is filed and the day before the penalty date, the amount of the penalty is based on the varied or corrected amount.

An amount paid by the taxpayer or applied by the CIR on account of the taxpayer, in relation to unpaid tax and a penalty under s 141ED of the TAA, must first be applied towards payment of the penalty.

More than one penalty may be imposed on a taxpayer in relation to the same employer monthly schedule. However, the total penalties that may be imposed under s 141ED of the TAA may not exceed 150 per cent of the returned amount that is unpaid when the first penalty is imposed.

A taxpayer is not liable to pay a penalty for not paying an employer monthly schedule amount if the unpaid amount on the day before the CIR’s notice (under s 141ED(1)(b) of the TAA) is $100 or less [TAA, s 183F; see 1110.345].

1110.50 **New due date for payment of tax that is not a penalty** [TAA, s 142A]

If the CIR makes a new assessment of tax (ie an assessment of tax for which the taxpayer has not been assessed earlier), the CIR must fix a date for the payment of that tax that is at least 30 days after the date of the notice of assessment, and give notice of this date to the taxpayer in the notice of assessment.

If the CIR makes an amended assessment that increases the amount of tax assessed and the amended assessment is made less than 30 days before, or on or after the due date for the original tax assessed, the CIR must fix a date for the payment of the increase of tax that is at least 30 days after the date of the notice of assessment, and give notice of this date to the taxpayer in the notice of assessment.

The requirement to fix a due date as above does not apply:

(a) To any provisional tax that remains unpaid on an instalment date;
(b) If the new assessment referred to above is a default assessment;
(c) If the CIR has notified the taxpayer before the due date for the payment of the tax that the above provisions will not apply to the tax as calculated by the taxpayer, or to an amount of tax estimated by the taxpayer; or
(d) If the CIR considers that setting a new due date may prejudice the CIR’s ability to recover the tax.

For the above purposes, “tax” does not include a civil penalty.

1110.55 **Late payment penalty and provisional tax** [TAA, s 139C]

A late payment penalty will only arise on provisional tax that is unpaid at the expiry of an instalment date, or a CIR-set instalment date, to the extent that the provisional tax payable exceeds the provisional tax paid.

“CIR-set instalment date” means a date specified by the CIR under s 119(4)(a) of the TAA.

“Provisional tax paid” means the amount of provisional tax paid by the provisional taxpayer on or before the instalment date or CIR-set instalment date, and includes any amount of provisional tax:

(a) Paid in excess of the amount of provisional tax payable on any earlier instalment date for that tax year; and
(b) Not credited to the amount of provisional tax payable on any earlier instalment date for that tax year.

“Provisional tax payable” means:

(a) In respect of an instalment date and a taxpayer to whom s RC 10 applies [see 1150.30], the lesser of the amount calculated under s RC 10 and the amount calculated as payable under s RC 10 if the taxpayer’s RIT is substituted for the amount of provisional tax payable under s RC 5.
(b) In respect of an instalment date and a taxpayer to whom ss RC 10 and RC 21 applies [see 1150.80, 1150.82], the lesser of the amount calculated under ss RC 10 and RC 21 and the amount calculated as payable under ss RC 10 and RC 21 if the taxpayer’s RIT is substituted for item “residual income tax” in the formulae in s RC 10(2).
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(c) For an instalment date and a taxpayer to whom s RC 11 applies [see 1150.35], the lesser of the amount calculated under s RC 11 and the amount calculated as payable under s RC 11 if the GST ratio is substituted for a GST ratio which is calculated using the taxpayer’s RIT for the tax year and taxable supplies for the corresponding income year.

(d) In respect of a CIR-set instalment date, the provisional tax payable on that date in accordance with s 119(4)(a) of the TAA [see 1150.65].

1110.60 Where another person deducts and pays resident withholding tax [TAA, s 140]

For the purposes of determining a person’s liability to pay a late payment penalty, the person is treated as having withheld or accounted for an amount of tax if:

(a) They are liable to pay the late payment penalty for not withholding resident withholding tax (RWT) or not accounting for RWT; and

(b) They can satisfy the CIR that another person withheld the RWT or accounted for the RWT.

1110.65 Imputation penalty tax [TAA, s 140B]

A company that is liable to pay further income tax under ss OB 65 or OC 30 in respect of an end of year debit balance in its ICA or imputation additional tax under s OB 72, is also liable to pay imputation penalty tax. The penalty is 10 per cent of the amount of:

(a) Further income tax that gives rise to the liability for the imputation; or

(b) Imputation additional tax that gives rise to the liability for further imputation penalty tax.

1110.70 Foreign dividend payment penalty tax [TAA, s 140C]

A company that is liable to pay further foreign dividend payment (FDP) under s OC 30 in respect of an end of year debit balance in its foreign dividend payment account (FDPA) is also liable to pay FDP penalty tax. The amount of FDP penalty tax payable by a company is 10 per cent of the amount of further FDP that gives rise to the liability for the FDP penalty tax.

1110.75 Maori authority distribution penalty tax [TAA, ss 140CB, 181B]

A Maori authority that is liable to pay further income tax under ss OK 21 and OK 22 for an end of year debit balance in its Maori authority credit account (MACA) is also liable to pay a Maori authority distribution penalty tax. The amount of the penalty tax is 10 per cent of the amount of further income tax that gives rise to the penalty.

The CIR must remit a Maori authority distribution penalty tax to the extent that the CIR is satisfied that liability for the penalty arose because of:

(a) A debit arising to the MACA under s OK 17 in relation to an arrangement to obtain a tax advantage, and it is established subsequently that, in relation to the debit, a credit arises to the MACA under s OK 9;

(b) A refund of a Maori authority distribution having been sent to but not received by the Maori authority, or not having been known by the Maori authority to have been received, before the end of the tax year; or

(c) A debit arising to the MACA under s OK 13, and the Maori authority did not become aware of the debit in sufficient time to allow it to remove the debit balance before the end of the year.

The CIR must also remit any late payment penalty to the extent the CIR is satisfied that the penalty was imposed in respect of a Maori authority distribution penalty tax that has been remitted.

If the CIR remits a Maori authority distribution penalty tax because of (a) above, the CIR must also remit any late payment penalty to the extent the CIR is satisfied that the penalty was imposed in respect of the amount of further income tax that gave rise to the Maori authority distribution penalty tax so remitted.
1110.80 Non-electronic filing penalty [TAA, ss 139AA, 142G]

An employer, a portfolio investment entity, a portfolio investor proxy, or PAYE intermediary is liable to a non-electronic filing penalty if the person does not furnish an employer monthly schedule and a PAYE income payment form in the prescribed format. The penalty does not apply if the employer is authorised under s 36B(1) of the TAA to furnish the schedule in a format that is not prescribed.

The non-electronic filing penalty is the greater of $250 or $1 for each employee employed at any time during the month to which the employer monthly schedule relates. The penalty is due for payment on the fifth day of the month following the month in which the employer monthly schedule in electronic format was due.

1110.85 Tax shortfalls

The following table from TIB vol 8:7 (October 1996) at 10, summarises the breaches and shortfall penalty rates, including adjustments that may be made for disclosure and for obstruction.

<table>
<thead>
<tr>
<th>Action subject to penalty</th>
<th>Standard penalty rate</th>
<th>Reduced by 75% for disclosure before notification of audit</th>
<th>Reduced by 40% for disclosure after notification of audit</th>
<th>Reduced by 75% for disclosure when filing</th>
<th>Increased by 25% for obstruction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of reasonable care</td>
<td>20%</td>
<td>5%</td>
<td>12%</td>
<td>n/a*</td>
<td>25%</td>
</tr>
<tr>
<td>Unacceptable tax position</td>
<td>20%</td>
<td>5%</td>
<td>12%</td>
<td>5%</td>
<td>25%</td>
</tr>
<tr>
<td>Gross carelessness</td>
<td>40%</td>
<td>10%</td>
<td>24%</td>
<td>n/a*</td>
<td>50%</td>
</tr>
<tr>
<td>Abusive tax position</td>
<td>100%</td>
<td>25%</td>
<td>60%</td>
<td>25%</td>
<td>125%</td>
</tr>
<tr>
<td>Evasion</td>
<td>150%</td>
<td>37.5%</td>
<td>90%</td>
<td>n/a*</td>
<td>187.5%</td>
</tr>
</tbody>
</table>

* This reduction is limited to the unacceptable tax position and abusive tax position penalties because it specifically relates to the disclosure of the taxpayer’s interpretation at time of filing.

The following flow chart, also from TIB vol 8:7 (October 1996), summarises how to determine whether an action is subject to a penalty, and the penalty rate that will apply.
**Penalties and Interest**

**1110.90** Not taking reasonable care [TAA, s 141A]

Inland Revenue acknowledges the contribution of the New Zealand Institute of Chartered Accountants in developing this diagram.

* The threshold referred to in the flowchart is the greater of:
  - $10,000; or
  - Lesser of one per cent of tax, or $200,000.

A taxpayer is liable to pay a shortfall penalty if the taxpayer does not take reasonable care in taking a tax position and the taking of that tax position results in a tax shortfall. The penalty payable for not taking reasonable care is 20 per cent of the resulting tax shortfall.

Inland Revenue acknowledges the contribution of the New Zealand Institute of Chartered Accountants in developing this diagram.

* The threshold referred to in the flowchart is the greater of:
  - $10,000; or
  - Lesser of one per cent of tax, or $200,000.

**1110.90** Not taking reasonable care [TAA, s 141A]

Inland Revenue acknowledges the contribution of the New Zealand Institute of Chartered Accountants in developing this diagram.

* The threshold referred to in the flowchart is the greater of:
  - $10,000; or
  - Lesser of one per cent of tax, or $200,000.

**1110.90** Not taking reasonable care [TAA, s 141A]

A taxpayer is liable to pay a shortfall penalty if the taxpayer does not take reasonable care in taking a tax position and the taking of that tax position results in a tax shortfall. The penalty payable for not taking reasonable care is 20 per cent of the resulting tax shortfall.
Penalties and Interest

1110.90

Note: A taxpayer who, in taking a tax position, relies on an action or the advice of a tax adviser engaged by the taxpayer, or by a company in the same group of companies as the taxpayer, takes reasonable care in relying on the action or advice. However, this does not apply if any one or more of the following apply:

(a) The taxpayer is the employer of the tax adviser;
(b) The taxpayer does not provide the tax adviser with adequate information relating to their tax position;
(c) The taxpayer does not provide the tax adviser with adequate instructions relating to the tax position;
(d) The taxpayer has reason to believe that the action or advice is incorrect;
(e) The taxpayer has previously (for a period ending less than four years before the beginning of the period to which the tax position relates) had a tax shortfall for the same type of tax arising from a corresponding tax position and does not take reasonable care to avoid the further tax shortfall.

A taxpayer who takes an acceptable tax position has also taken reasonable care in taking their tax position. However, this does not prevent a taxpayer who makes a mistake in the calculation or recording of numbers in a return from being liable for a penalty for not taking reasonable care. An acceptable tax position is an interpretation that is not an unacceptable tax position [see 1110.95].

If the CIR assesses a penalty for not taking reasonable care after cancelling (under s 141KB) a shortfall penalty assessed under s 141B (for taking an unacceptable tax position), the liability for the penalty for not taking reasonable care arises at the same time as the s 141B penalty is cancelled. (Note: s 141KB of the TAA was repealed for tax positions taken from 1 April 2008.)

“Tax position” means a position or approach with regard to tax under one or more tax laws, including without limitation a position or approach with regard to:

(a) A liability for an amount of tax, or the payment of an amount of tax;
(b) An obligation to deduct or withhold an amount of tax, or the deduction or withholding of an amount of tax;
(c) A right to a tax refund, or to claim or not to claim a tax refund;
(d) A right to a credit of tax, or to claim or not to claim a credit of tax;
(e) The provision of a tax return, or the non-provision of a tax return;
(f) The derivation of an amount of income or exempt income or a capital gain, or the inclusion or non-inclusion of an amount in income;
(g) The incurring of an amount of expenditure or loss, or the allowing or denying as a deduction of an amount of expenditure or loss;
(h) The availability of a tax loss component or loss balance, or the use of a tax loss component or loss balance;
(i) The attaching of a credit of tax, or the receipt of or lack of entitlement to receive a credit of tax;
(j) The balance of a tax account or memorandum account of any type or description, or a debit or credit to such an account;
(k) The estimation of provisional tax payable;
(l) Whether the taxpayer must request an income statement [see 1270.75] or respond to an income statement issued by Inland Revenue;
(m) The application of s 33A(1) of the TAA;
(n) A right to a tax credit; and
(o) The amount of a payroll subsidy, claimed under s RP 4, to a listed PAYE intermediary [TAA, s 3(1)].

“Taxpayer’s tax position” means a tax position taken by a taxpayer in, or in respect of, a tax return, a due date, or an income statement [TAA, s 3(1)].
If a taxpayer who has an obligation under the PAYE, FBT, employer’s superannuation contribution, RWT, NRWT or FDP rules furnishes a return under any of those rules, but pays (by the due date) less than the amount shown in the return, the taxpayer’s tax position becomes the tax paid and not the amount shown as payable in the return [TAA, s 4A(4)].

If a taxpayer does not provide a tax return for a return period, the taxpayer is deemed to take, for each type of tax and for each due date, a tax position based on the amount of tax actually paid [TAA, s 4A(5)].

The CIR’s policy on reasonable care is set out in TIB vol 8:7 (October 1996) at 11-14. The TIB contains useful examples.

In 2005 the CIR issued an interpretation statement in relation to the shortfall penalty for not taking reasonable care [see TIB vol 17:9 (November 2005) at 3-25]. The interpretation statement provides a detailed analysis of the shortfall penalty for not taking reasonable care, but the main features of the statement are:

(a) The standard of “reasonable care” in respect of s 141A of the TAA involves establishing what a reasonable person would do in the same circumstances, and takes into account such factors as the age, health, and background of the taxpayer in question.

(b) The statement provides guidance as to how the standard of reasonable care is applied to various types of taxpayers, (eg businesspersons, clients of agents, and tax specialists). It also examines how the reasonable care standard applies in certain situations such as receipt of Inland Revenue advice, complexity of the law, materiality, and arithmetical errors.

(c) The reasonable care standard does not mean perfection, but refers to the effort required commensurate with the reasonable person in the taxpayer’s circumstances.

(d) In determining whether the standard of reasonable care has been met, the CIR will consider the likelihood of a tax shortfall, the quantum of the shortfall and the difficulty of preventing a tax shortfall.

(e) Although a taxpayer is liable for the actions of their employees, the question of whether the taxpayer has taken reasonable care must still be considered [see Example 1 (below)].

(f) The shortfall penalty payable by the taxpayer for not taking reasonable care can be reduced for the taxpayer’s previous behaviour, voluntary disclosure or where the tax shortfall is temporary. The penalty can also be increased where the taxpayer obstructs the CIR.

(g) In the CIR’s view, s 141JAA of the TAA, which provides for the penalty payable to be capped in some situations, is only applicable after other reductions have been made.

**Example 1:**
A staff member of a large business makes an error of $10,000 in transferring figures from work papers to the GST return. The owner of the business is aware that the same staff member made a similar transposition error in the previous period’s GST return. In this case, it could be concluded that a reasonable owner would have foreseen a risk and put simple checks in place that would at least reduce the risk of obvious errors. Therefore, the taxpayer would be liable for a shortfall penalty for not taking reasonable care in respect of the second shortfall. Whether the first shortfall would give rise to a penalty would depend on the particular circumstances of the error in that instance.

**Example 2:**
A taxpayer returns $50,000 taxable income but omits a further $10,000 from his return. It can be accepted from the proportionally large amount of the omission that the taxpayer should have been aware that not all income had been returned. This is regardless of whether or not the taxpayer used an agent to complete his return. The tax shortfall is large relative to the taxpayer’s taxable income. In the absence of any special circumstances, the taxpayer breached the standard of reasonable care in this case.

**Example 3:**
A large company returns taxable income of $50,000,000, but omits an additional $10,000 of assessable income. Subject to consideration of the circumstances that led to the error, the amount of the omission when compared with the taxable income of the company does not support the view that there was a lack of reasonable care. The tax shortfall, in relation to the taxable income, may mean that the company, despite the error, still took reasonable care in the preparation of its income tax return.
The interpretation statement applies to the ITA 1994 (from the 1997-1998 to the 2004-2005 income years inclusive), the ITA 2004 (from the 2005-2006 income year), and the GSTA 1985 (from taxable periods commencing from 1 April 1997).

A solicitor who, during an Inland Revenue audit, was unable to provide source documents to support 112 deposits made into his bank accounts over two income years was found by the TRA to have demonstrated a lack of reasonable care, not gross carelessness. He had allowed his financial affairs to become muddled and had failed to maintain adequate records for income tax purposes. To some extent, his failure was caused by his health problems: TRA Case Y21 (2008) 23 NZTC 13,227.

1110.95 Unacceptable tax position [TAA, s 141B]

(1) Determining whether tax position is unacceptable

A taxpayer takes an “unacceptable tax position” if (viewed objectively), the tax position they take fails to meet the standard of being about as likely as not to be correct. A taxpayer does not take an unacceptable tax position merely by making a mistake in the calculation or recording of numbers used in, or for use in preparing, a return. Whether a tax position is acceptable or unacceptable is determined as at the time at which the taxpayer takes their tax position.

A taxpayer does not take an unacceptable tax position to the extent to which they have taken their position because they have relied on an official opinion of the CIR, where that opinion is given by the CIR on or after 7 September 2010.

The CIR’s official opinion means:

- An opinion of the CIR concerning the tax affairs of the taxpayer, given by the CIR, either orally or in writing, after all information relevant to forming the opinion has been provided to the CIR, if that information is correct;
- A finalised written official statement of the CIR, if it specifically applies to the taxpayer’s situation.

Private binding rulings are not official opinions.

The time at which a taxpayer takes a tax position for a return period is:

(a) The time at which the taxpayer provides the return containing the taxpayer’s tax position, if the taxpayer provides a tax return for the return period; or

(b) The due date for providing the tax return for the return period, if the taxpayer does not provide a tax return for the return period.

The matters that must be considered in determining whether a taxpayer has taken an unacceptable tax position include:

(a) The actual or potential application to the tax position of all the tax laws that are relevant, including specific or general anti-avoidance provisions; and

(b) Decisions of a Court or a TRA on the interpretation of tax laws that are relevant (unless the decision was issued up to one month before the taxpayer takes their tax position).

A partner in a New Zealand accountancy partnership (that was part of an international brand) resigned from the partnership and went to work for the brand in Indonesia. He ceased working for the New Zealand firm on 31 October 2000, and became a New Zealand non-resident in early November 2000. For the income year ended 30 June 2001, he received income of $286,074 from the New Zealand firm. This amount represented income for the period from 1 July to 31 October 2000. However, he included only $75,513 (one-third of the total after adjustments) in his 2001 income tax return on the grounds that the income was derived over the year as a whole and that he was only resident in New Zealand for four months of the 2001 income year. He argued that the rest of the income for that year was derived while he was a non-resident and was therefore excluded by the DTA with Indonesia or by s BD 1(2)(c) of the ITA 1994 [s BD 1(4) of the ITA 2007; non-residents’ foreign-sourced income]. The court rejected this argument and held that the whole amount of $286,074 had a New Zealand source (being derived from a New Zealand business), was derived while he was a New Zealand
resident (ie before 31 October 2000), and should have been included in his 2001 income tax return. As a consequence the taxpayer was liable to pay a tax shortfall under s 141B of the TAA for taking an unacceptable tax position. The taxpayer failed to meet the standard that his interpretation was about as likely as not to be correct. The law could not have been interpreted in favour of the taxpayer. The penalty was reduced to 10 per cent of the tax shortfall under s 141FB. See TRA Case Z1 (2009) 24 NZTC 14,001.

(2) Shortfall thresholds and penalty rates
A taxpayer is liable to pay a shortfall penalty of 20 per cent of the tax shortfall if the taxpayer takes an unacceptable tax position and the tax shortfall arising from the taxpayer’s tax position is more than both:
(a) $50,000; and
(b) One per cent of the taxpayer’s total tax figure for the relevant return period.

The Governor-General by Order in Council may vary these amounts from time to time.

The penalty was originally referred to as “unacceptable interpretation”. However, s 141B of the TAA was amended with effect from 1 April 2003 and the name of the penalty was changed to “unacceptable tax position”. A different approach is required in determining liability for the two penalties, as set out below.

(3) Interpretation and definitions
For the purpose of determining whether the resulting tax shortfall is in excess of the above amounts, a tax return provided by a partnership, a look-through company, or any other group of persons that derive or incur amounts jointly or are assessed together is to be treated as if it were a tax return of every taxpayer who is a partner in the partnership, effective look-through interest holder for the look-through company, or person in such group. The tax rate applying with respect to a partnership is deemed to be the same as the basic rate of income tax for companies for the relevant period.

A taxpayer’s “total tax figure” is:
(a) The amount of tax paid or payable by the taxpayer in respect of the return period for which the taxpayer takes a tax position before (in the case of income tax) any group offset election or subvention payment; or
(b) Where the taxpayer has no tax to pay in respect of the return period, an amount equal to the product of:
   (i) The net loss of the taxpayer for the return period, treated as having a positive value; and
   (ii) The basic rate of income tax for companies in the relevant return period, that is shown as tax paid or payable, or as a net loss of the taxpayer, or as a refund to which the taxpayer is entitled, in a tax return provided by the taxpayer for the return period [TAA, s 141B(3)].

(4) The CIR’s position — background
The CIR’s interpretation statement in relation to the shortfall penalty for an unacceptable tax position [see TIB vol 17:9 (November 2005) at 26-53], is summarised below.

The matters that must be considered in determining whether a taxpayer has taken an unacceptable tax position include:
(a) The making of an “interpretation or an interpretation of an application of a tax law” is no longer required for the application of s 141B.
(b) To take an unacceptable tax position, a taxpayer is required merely to take a tax position that, when viewed objectively, fails to meet the standard of being about as likely as not to be correct.
(c) An unacceptable interpretation of the law can give rise to an unacceptable tax position, but is no longer a requirement of s 141B.
(d) The threshold levels, which a tax shortfall must exceed to qualify as an unacceptable tax position, have increased.
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(e) Penalties of 20 per cent may be reduced to 10 per cent as a result of a taxpayer’s prior good compliance.

(f) In the CIR’s view, s 141JAA, which provides for the penalty payable to be capped in some situations, is only applicable after all other reductions have been made.

1110.100 Gross carelessness [TAA, s 141C]

A taxpayer is liable to pay a shortfall penalty if the taxpayer is grossly careless in taking a tax position. The penalty payable for gross carelessness is 40 per cent of the resulting tax shortfall. Gross carelessness means doing or not doing something in a way that, in all the circumstances, suggests or implies complete or a high level of disregard for the consequences. A taxpayer is not grossly careless if they take an acceptable tax position.

The CIR’s policy on gross carelessness is set out in TIB vol 8:7 (October 1996) at 18-19. The TIB contains useful examples.

The CIR’s interpretation of the shortfall penalty for gross carelessness is set out in TIB vol 16:8 (September 2004) at 10-17. The interpretation statement, which draws mainly on TRA Case W4 (2003) 21 NZTC 11,034, for its interpretive analysis, argues that gross carelessness is similar to recklessness but, unlike evasion which also involves recklessness, it does not require an intent to breach a tax obligation. The statement identifies the following characteristics as likely to indicate that a taxpayer has been grossly careless:

(a) A complete or high level of disregard for the consequences;
(b) A high risk of a tax shortfall occurring;
(c) Failing to give any thought to an obvious and serious risk;
(d) A reasonable person in the circumstances would have foreseen the risk involved in, and the consequences of, grossly careless conduct;
(e) Gross carelessness involves more than mere inadvertence or lack of reasonable care;
(f) Whether or not gross carelessness is present will depend upon the circumstances in each case; and
(g) The test for whether or not gross carelessness is present is objective, being similar to that for “recklessness”.

According to the statement, the following characteristics will distinguish gross carelessness from lack of reasonable care:

(a) A large tax shortfall is involved (resulting either from a single transaction or a number of similar transactions);
(b) The transaction (or transactions of a similar nature when viewed together) is significant when compared to the taxpayer’s business;
(c) Indifference by the taxpayer to an obvious risk of a possible tax shortfall occurring;
(d) A relatively short period of time between the purchase and sale of an item where the purchase triggered a tax effect that the taxpayer recognised;
(e) The taxpayer being experienced in the relevant tax laws; and
(f) A failure by the taxpayer to heed previous warnings or to take on board suggestions of tax advisers (either Inland Revenue or independent) aimed at reducing the likelihood of errors occurring.

Example:

Mr D runs a building recycling operation, buying and selling material and fittings from buildings that have been demolished or refurbished. His suppliers are both registered and unregistered persons for GST purposes. He claims input tax credits on the material purchased from the unregistered persons under the secondhand goods provisions of s 20(3)(a)(ia) of the GSTA, which allow an input tax deduction only to the extent that payment has been made. When his tax affairs are investigated, it is discovered that Mr D claimed a number of input tax credits on secondhand goods purchased from unregistered persons in the taxable period ended 31 March 2003 based on the full purchase prices totalling $36,000 when, during that period, he had only paid $5,000 of the total amount due. During past investigations, similar mistakes have been identified where the input tax credit claimed was based on the full purchase price rather than on the amount paid during the taxable period in question. The Inland Revenue investigator gave Mr D advice on how he could improve his bookkeeping system so that similar errors would not occur in the future.
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future. Despite 12 months having elapsed since this advice was given, the taxpayer had failed to implement the suggested improvements. In relation to the taxable period now being investigated, the taxpayer stated that the mistake was the result of mere inadvertence. The CIR proposes to impose a shortfall penalty for gross carelessness on the resulting tax shortfall.

In this instance, buying secondhand goods is a regular part of the taxpayer’s business. The fact that recording or calculation errors by the taxpayer have previously been identified on a number of occasions is an indication that a reasonable person, in the same circumstances, would have recognised the obvious and serious risk involved. As such, the errors are not the type of mistakes that occur because of mere inadvertence and which do not suggest or imply complete or a high level of disregard for all the consequences so as to constitute gross carelessness. Rather, in this case, once the nature of the errors had been identified, and it was recognised that such errors could potentially recur on a regular basis, a reasonable person would have ensured that such errors did not recur by following the advice previously given and putting in place an adequate record keeping system, including checks, to identify goods purchased from unregistered persons. Not to have done so indicates indifference to the serious risk of this type of error recurring and a high level of disregard for the consequences. Therefore, Inland Revenue considers that the taxpayer has been grossly careless and that a shortfall penalty under s 141C should be imposed.

See TIB vol 16:8 (September 2004) at 10-17 for further examples.

1110.105 Abusive tax position [TAA, s 141D]

A taxpayer is liable to pay a shortfall penalty if the taxpayer takes an abusive tax position. The intention is to penalise those taxpayers who, having taken an unacceptable tax position, have entered into or acted in respect of arrangements or interpreted or applied tax laws with a dominant purpose of taking, or of supporting the taking of, tax positions that reduce or remove tax liabilities or give tax benefits.

The penalty payable for taking an abusive tax position is 100 per cent of the resulting tax shortfall.

The penalty for taking an abusive tax position is reduced to 20 per cent of the resulting tax shortfall if:

(a) The taxpayer is a party to an arrangement to which s 141EB applies (ie an arrangement that is promoted by a promoter to 10 or more persons in an income year) and becomes liable to a shortfall penalty for an abusive tax position as a result of that arrangement, irrespective of whether a promoter penalty has been imposed for the arrangement;

(b) The sum of the tax shortfalls from the arrangement for the taxpayer and persons associated with the taxpayer is less than $50,000; and

(c) The taxpayer has independent advice stating that the taxpayer’s tax position is not an abusive tax position.

The time at which a taxpayer takes a tax position for a return period is:

(a) The time at which the taxpayer provides the return containing the taxpayer’s tax position, if the taxpayer provides a tax return for the return period; or

(b) The due date for providing the tax return for the return period, if the taxpayer does not provide a tax return for the return period.

A taxpayer’s tax position may be an abusive tax position if the tax position is an incorrect tax position under, or as a result of, either or both:

(a) A general tax law;

(b) A specific or general anti-avoidance tax law.

“Abusive tax position” means a tax position that:

(a) Is an unacceptable tax position at the time the tax position is taken; and

(b) Viewed objectively, the taxpayer takes:

(i) In respect of, or as a consequence of, an arrangement that is entered into with a dominant purpose of avoiding tax, whether directly or indirectly; or

(ii) Where the tax position does not relate to an arrangement described in point (i), with a dominant purpose of avoiding tax, whether directly or indirectly.

A husband and wife advanced $154,000 to a charitable trust of which they were the sole trustees. They then borrowed $154,000 from the trust under the terms of a “bond agreement”. The bond agreement provided for compound interest at 10 per cent per annum to be accrued.
Penalties and Interest

on the loan until repaid. Repayment was set for 40 years after the loan was advanced. The amount borrowed was to be used to buy shares in a vineyard company. The taxpayers claimed tax deductions calculated using the straight line method spread evenly over the 40 years [see 470.50] (ie calculated at 10 per cent compounding over 40 years). This resulted in full-year tax deductions of $198,117. The court held that the dominant purpose of the arrangement was tax avoidance, and that the taxpayers were liable for a penalty under s 141D of the TAA for taking an abusive tax position. See TRA Case Z1 (2009) 24 NZTC 14,001.

(1) CIR’s position

The CIR’s interpretation statement on the shortfall penalty for taking an abusive tax position is set out in TIB vol 18:1 (February 2006) at 24-35. The statement provides that before the penalty can potentially apply, the following requirements must be satisfied:

(a) The taxpayer must have taken a tax position;
(b) The tax position must be an incorrect tax position under or as a result of a general tax law or a specific or general anti-avoidance law;
(c) The time at which a taxpayer’s tax position has been taken has been determined in accordance with s 141B(6) of the TAA (see above);
(d) The taxpayer’s tax position leads to a tax shortfall, and that tax shortfall exceeds $20,000; and
(e) The taxpayer has taken an unacceptable tax position.

If the above requirements are met, a penalty can arise under s 141D of the TAA in one of two ways. The s 141D penalty can apply whether or not there is an arrangement.

Under s 141D(7)(b)(i) a penalty will apply if there is an arrangement and the dominant purpose of that arrangement is tax avoidance. It is the CIR’s view that, under subparagraph (i), it is the arrangement that must have the dominant purpose of tax avoidance, not the taxpayer. Thus the taxpayer does not have to have a dominant purpose of avoiding tax for this provision to apply. A penalty will arise under (i) if a taxpayer has taken their tax position (which is an unacceptable tax position) directly or indirectly in respect of or as a consequence of an arrangement that they have personally entered into, and the dominant purpose of the arrangement is tax avoidance.

Under s 141D(7)(b)(ii) a penalty will arise if there is no arrangement, or there is no arrangement of the kind described in s 141D(7)(b)(i), and the dominant purpose of the taxpayer in taking their tax position is tax avoidance. Subparagraph (ii) will apply where there is an unacceptable tax position and the taxpayer takes the tax position with the dominant purpose of avoiding tax. Subparagraph (ii) is therefore potentially applicable where there is no arrangement, or where there is an arrangement but it cannot be shown that the arrangement itself has a dominant purpose of avoiding tax.

“Dominant purpose of avoiding tax” means that the most influential and prevailing purpose of the arrangement or the taxpayer (as applicable) is to avoid tax.

The CIR’s approach to determining an abusive tax position before 1 April 2003 was set out in standard practice statement INV-215 [TIB vol 10:3 (March 1998) at 17-20]. The statement was withdrawn in TIB vol 15:6 (June 2003) at 19 following changes to the shortfall penalty provisions.

1110.110 Evasion or similar act [TAA, s 141E]

A taxpayer is liable to pay a shortfall penalty if, in taking a tax position, the taxpayer:

(a) Evades the assessment or payment of tax by the taxpayer or another person under a tax law;
(b) Knowingly applies or permits the application of the amount of a deduction or withholding of tax made or deemed to be made under a tax law for any purpose other than in payment to the CIR;
(c) Knowingly does not make a deduction, withholding of tax (or transfer of payroll donation from 6 January 2010), required to be made by a tax law;
Penalties and Interest

(d) Obtains a refund or payment of tax, knowing that the taxpayer is not lawfully entitled to the refund or payment under a tax law;

(e) Attempts to obtain a refund or payment of tax, knowing that they are not lawfully entitled to the refund or payment under a tax law;

(f) Enables another person to obtain a refund or payment of tax, knowing that the other person is not lawfully entitled to the refund or payment under a tax law; or

(g) Attempts to enable another person to obtain a refund or payment of tax, knowing that the other person is not lawfully entitled to the refund or payment under a tax law.

The penalty payable for evasion or a similar act is 150 per cent of the resulting tax shortfall.

A person will not be charged with a shortfall penalty under (b) above if that person satisfies the CIR that the amount of the deduction has been accounted for, and that the person’s failure to account for it within the prescribed time was due to illness, accident, or some other cause beyond the person’s control.

A person will not be charged with a shortfall penalty under (b) above if the person is chargeable with a shortfall penalty under s 141ED of the TAA for the same tax position.

If a taxpayer enables or attempts to enable another person to obtain a refund or payment of tax, knowing that the other person is not lawfully entitled to the refund or payment under a tax law, the taxpayer is liable to pay to the CIR an amount equal to the shortfall penalty that would have been imposed if the other person’s tax position had been the taxpayer’s tax position.

Evasion may also be treated as a crime under s 143B of the TAA [see 1110.235]. A taxpayer may be liable to a shortfall penalty for evasion, a criminal penalty for evasion (upon conviction), or both. The CIR can impose a shortfall penalty after a taxpayer has been prosecuted for evasion, even if the prosecution is not successful. However, the CIR may not prosecute a taxpayer for evasion in relation to a tax shortfall if a shortfall penalty has already been imposed [TAA, s 149].

The CIR’s policy on evasion or similar acts is set out in TIB vol 8:7 (October 1996) at 21, 22. The TIB contains useful examples.

(1) CIR’s interpretation statement

The CIR’s interpretation statement on the shortfall penalty for “evasion or a similar act” is set out in TIB vol 18:11 (December 2006) at 7-22. The statement includes a detailed analysis of relevant case law. The following is a summary only of the main points of the statement.

Evasion occurs when a taxpayer deliberately breaches a tax obligation. The required mental element (mens rea) for evasion will be present if a taxpayer knew or strongly suspected that their course of conduct would breach a tax obligation. In other words, evasion requires intentional behaviour or subjective recklessness; negligence and carelessness are insufficient. In determining whether to impose a shortfall penalty for evasion the CIR will consider a number of criteria including:

(a) Whether the taxpayer has been previously prosecuted and/or subject to shortfall penalties for evasion;

(b) The reason given by the taxpayer for their behaviour;

(c) The degree of culpability of the taxpayer;

(d) The likelihood of future compliance;

(e) The degree of cooperation received from the taxpayer;

(f) The effect on promoting voluntary compliance; and

(g) The duty to protect the integrity of the tax system.

Where the taxpayer has been prosecuted for evasion the following additional factors will be considered:

(a) Whether the taxpayer was successfully prosecuted under s 143B of the TAA; and

(b) Comments made by the judge in sentencing the offender (in the event of a successful prosecution).
A taxpayer’s intention is relevant in determining whether the person has evaded the assessment or payment of tax. Simply establishing that a person has failed to return or pay tax on an amount will not be sufficient to prove evasion. The intention or *mens rea* element of evasion will be satisfied if the taxpayer knew that their act or omission was in breach of a tax obligation.

The CIR contends that “subjective recklessness” is sufficient to satisfy the *mens rea* requirement of evasion. A taxpayer is subjectively reckless if the taxpayer avoids tax in circumstances where the taxpayer knew or strongly suspected that their conduct would breach a tax obligation. If the taxpayer strongly suspects an obligation may exist but does not investigate further before taking a tax position this could amount to recklessness and evasion if a tax shortfall results (see the example below). Recklessness is the conscious taking of a risk; knowing the facts and choosing to ignore them or the need to be on enquiry to which they give rise. By contrast, if a taxpayer is honestly unaware of (and has no reason to be on enquiry as to) an obligation so has no intention to try to avoid it (ie is “objectively reckless”), the penalty for evasion will not apply. However, a penalty for gross carelessness or lack of reasonable care may apply.

Unlike other shortfall penalties, where the onus lies with the taxpayer, the onus of proof in relation to a shortfall penalty for evasion is with the CIR, and the standard of proof is the balance of probabilities [TAA, s 149A]. The CIR must therefore prove that it is more likely than not that the taxpayer has the requisite *mens rea* for evasion. The test for evasion is subjective — the requisite knowledge or intention may be inferred through an objective analysis of the surrounding circumstances and conduct.

“Knowingly”, in relation to an act or failure to act, requires knowledge of the doing of the act (or omission) that amounts to a breach. It is a subjective test that can be satisfied by recklessness. Negligence or carelessness is insufficient to satisfy the test.

**Example:**
Mr B, who had been teaching overseas, returned to New Zealand leaving $300,000 invested in the country in which he had been living. He had been told by the investment company at the time of investing the money that the investment income was tax free within that country and New Zealand. For some time after his return to New Zealand he continued to hold that view. He did not mention the investment income when filing his New Zealand tax returns for the next 10 years. During these 10 years, he said he had gradually become unsure as to whether the income was taxable. The uncertainty, he said, had come from discussions with friends, where he had been given two differing viewpoints. He said he thought perhaps he was not liable for tax, but as time went on his doubts grew. He said that after making further enquiries in about year five he was almost certain that the investment income was taxable, but by that stage he was too afraid of the financial consequences of contacting Inland Revenue.

The intention or *mens rea* element of evasion relates to breaching a known tax obligation or a tax obligation which the taxpayer strongly suspects may exist. Initially there is no intent to evade a known or suspected obligation, so the behaviour does not amount to evasion, although the taxpayer may be liable to a gross carelessness penalty. However, the behaviour later crosses the borderline into evasion. Here, from at least year five, Mr B strongly suspected an obligation may exist but he chose not to investigate further (for example, by making enquiries of Inland Revenue or getting advice from an accountant or lawyer) as he did not want to have his suspicions confirmed. He chose to close his eyes to this issue by deliberately and intentionally refraining from taking any steps to discover the tax status of the income he received. This disregard of a suspected obligation from at least year five amounts to subjective recklessness, which is sufficient *mens rea* for evasion.

**1110.115 Promoter penalty [TAA, ss 141EB, 141EC]**

The promoter of an arrangement is liable to a promoter penalty if:

(a) A taxpayer becomes a party to the arrangement and a shortfall penalty for an abusive tax position is imposed on the taxpayer as a result of the arrangement; and

(b) The arrangement is offered, sold, issued or promoted to 10 or more persons in a tax year. An arrangement is treated as being offered, sold, issued or promoted to 10 or more persons if 10 or more persons claim tax-related benefits as a result of the arrangement.

A “promoter” of an arrangement means:

(a) A person who is a party to, or is significantly involved in formulating, a plan or programme from which an arrangement is offered; or

(b) A person who is aware of material and relevant aspects of the arrangement and who sells, issues or promotes the selling or issuing of, the arrangement, whether or not for remuneration.
The promoter penalty applies to arrangements entered into from 26 March 2003. A person whose involvement
with an arrangement is limited to providing legal, accounting, clerical or secretarial services to a promoter
is not a promoter.

If an arrangement is offered, sold, issued or promoted to a LAQC or a partnership, the arrangement is treated
as being offered, sold, issued or promoted to all the shareholders of the LAQC or all the partners in the
partnership.

The amount of the promoter penalty is the sum (not less than nil) of the tax shortfalls resulting from taking
an abusive tax position on the arrangement, for which the promoter would have been liable if the promoter had:

(a) Been a party to the arrangement in the place of each party to the arrangement to whom the arrangement
    was offered, sold, issued or promoted;
(b) Taken a tax position under which the arrangement is treated as producing for the promoter the tax-
    related benefits that were intended by the parties to the arrangement; and
(c) Had the taxation-related characteristics that would, under the tax position referred to in (b), produce
    for the promoter the maximum taxation-related benefits from the arrangement.

In plain language, the promoter penalty is the total of all the tax benefits (calculated at the highest marginal
tax rate) that all the parties who took advantage of the arrangement have received from the arrangement.

Each promoter’s liability for the promoter penalty depends on whether they fall within part (a) or part (b) of
the definition of promoter (see above). For ease of reference, promoters who fall within part (a) of the
definition are referred to here as “planners”, and those who fall within part (b) are referred to as “marketers”.

(a) Planners:
    (i) Jointly and severally liable with any other planners for the whole promoter penalty; and
    (ii) Jointly and severally liable with each marketer for the part of the penalty for which the
         marketer is liable.

(b) Marketers:
    (i) Jointly and severally liable, with all other promoters, for the portion of the penalty relating
        to taxpayers to whom the marketer has offered, sold, issued or promoted the arrangement.

**Example 1:**

An accountant in private practice works closely with an entrepreneur to design a scheme and prepare offer documents. The
entrepreneur offers an arrangement to at least 10 people who claim tax-related benefits. The knowledge and role of the accountant
would indicate that they were significantly involved in formulating a plan. Accordingly, they would be considered to be a
promoter for the purposes of the promoter penalty provisions. Other factors to consider may be whether the financial adviser is
paid for their services or receives a share of the proceeds.

**Example 2:**

Following on from the previous example, a financial adviser, who was not involved in formulating the plan, offers an arrangement
to their clients. The financial adviser, who is aware of material and relevant aspects of the arrangement, is considered to be a
promoter for the purposes of the promoter penalty provisions. Whether or not the financial adviser received remuneration is not
relevant.

**Example 3:**

An arrangement is offered to a LAQC with three shareholders, and another company with six shareholders. That will count as
an offer to four persons — three through the LAQC and one for the other company.

**Example 4:**

A promoter sells an arrangement to 11 investors, designed to give them a deduction of $30,000 each. Using the maximum income
tax rate of 33 per cent, the sum of these maximum taxation benefits is $11 × $30,000 × 33 per cent, or $108,900. Accordingly,
the amount of the promoter penalty is $108,900.
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1110.120 Officers liable to pay shortfall penalties [TAA, s 141F]

If a taxpayer is required to make or account for a deduction or withholding of tax under a tax law and an officer of the taxpayer fails to make the deduction or withholding of tax or applies or permits to be applied the amount of the deduction or withholding of tax other than in payment to the CIR, one shortfall penalty, calculated under Part 8, may be imposed for each tax position taken by the taxpayer. The CIR may apportion the shortfall penalty between the taxpayer and the officers on the basis of:

(a) The acts or omissions of the taxpayer and the officers; and

(b) Whether those acts or omissions were reasonable in the circumstances.

The CIR’s policy on the imposition of penalties on officers is set out in TIB vol 8:7 (October 1996) at 22.

1110.125 Liability of wholly-owned groups and partners to pay shortfall penalties [TAA, s 94B]

If the CIR treats the companies in a wholly-owned group as if they were a single taxpayer for the purpose of determining a tax shortfall, one company in the group will be assessed for the shortfall penalty but all the other companies remain liable to pay the shortfall penalty until it is fully paid.

All the partners in a partnership, and all the persons in any other group of persons that derive income jointly or are assessed together, are individually and collectively liable for any shortfall penalties imposed. Where a shortfall penalty is imposed on a partnership, the part of that penalty imposed on each partner is in proportion to the partner’s share or interest in the partnership. Where a shortfall penalty is imposed on a group of persons other than a partnership, that penalty is imposed in such proportions as the CIR determines on any one or more of the persons in that group.

1110.130 Shareholders of LAQCs [TAA, s 141FD]

A shortfall penalty arising because a LAQC attributes a tax loss to a shareholder and the tax loss is subsequently reduced (because deductions claimed by the LAQC are disallowed or the gross income of the LAQC is increased) is imposed on the shareholder and not on the LAQC.

The penalty is imposed on the amount of the deduction the shareholder claimed for the attributed tax loss. No other shortfall penalty may be imposed on the shareholder in relation to the reduction of the tax loss.

1110.135 Reduction of penalty for previous behaviour [TAA, s 141FB]

Shortfall penalties are reduced by 50 per cent for taxpayers who have a good history of compliance. The rules vary depending on the type of shortfall penalty imposed.

(1) Penalty for evasion

A shortfall penalty (the current penalty) for evasion [TAA, s 141E] is reduced to 50 per cent if the taxpayer is not:

(a) Convicted of a disqualifying offence (see definition below); or

(b) Liable for a disqualifying penalty.

A disqualifying penalty for this purpose is a shortfall penalty that:

(a) Relates to the same type of tax as the current penalty;

(b) Is for evasion or a similar act;

(c) Is not reduced for voluntary disclosure; and

(d) Relates to a tax position taken from 26 March 2003 and before the date the taxpayer takes the tax position to which the current penalty relates.
(2) **Penalty for not taking reasonable care, unacceptable tax position, gross carelessness or abusive tax position**

A shortfall penalty (the current penalty) imposed under ss 141A to 141D of the TAA is reduced to 50 per cent if the taxpayer is not:

(a) Convicted of a disqualifying offence (see definition below); or

(b) Liable for a disqualifying penalty.

A disqualifying penalty for this purpose is a shortfall penalty that:

(a) Relates to the same type of tax as the current penalty;

(b) Is a shortfall penalty for evasion or a similar act, or for gross carelessness or taking an abusive tax position (if the current penalty is for gross carelessness or taking an abusive tax position);

(c) Is a shortfall penalty of any sort (if the current penalty is for not taking reasonable care or taking an unacceptable tax position);

(d) Is not reduced for voluntary disclosure; and

(e) Relates to a tax position taken:
   
   (i) From 26 March 2003;
   
   (ii) Within the specified time period (see below); and
   
   (iii) Before the taxpayer takes the tax position to which the current penalty relates.

If the CIR becomes aware of two or more tax shortfalls as a result of a single investigation or voluntary disclosure, the penalties are treated as one shortfall penalty if the taxpayer:

(a) Takes both tax positions at the same time; and

(b) Is not liable for a shortfall penalty at any time in the specified time period (ending on the earliest date that the taxpayer takes a tax position resulting in a tax shortfall).

A “disqualifying offence” is:

(a) An offence under ss 143A, 143B, 143F, 143G, 143H or 145 of the TAA for which a conviction is entered from 26 March 2003 and before the taxpayer takes the tax position to which the current penalty relates;

(b) An offence under ss 143 or 144 of the TAA that relates to the same type of tax as the current penalty does, for a conviction entered:
   
   (i) From 26 March 2003;
   
   (ii) Within the specified time period (see below); and
   
   (iii) Before the taxpayer takes the tax position to which the current penalty relates.

The specified time periods are:

<table>
<thead>
<tr>
<th><strong>Tax type</strong></th>
<th><strong>Specified time period</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>PAYE, FBT, GST, RWT</td>
<td>Two years before the tax position was taken, to which the current penalty relates</td>
</tr>
<tr>
<td>Any other tax type</td>
<td>Four years before the tax position was taken, to which the current penalty relates</td>
</tr>
</tbody>
</table>

(3) **Standard practice statement**


Key points arising from the SPS are as follows:
Penalties and Interest

(a) All taxpayers start with a “clean slate”. Any shortfall penalties imposed or convictions entered before 26 March 2003 (the date s 141FB of the TAA came into effect) are not taken into account in determining whether a current penalty will be reduced for previous behaviour.

(b) Generally, a conviction is entered after the final determination of the case, when the defendant is sentenced. A guilty plea is not a conviction. A judge may permit a guilty plea to be withdrawn before sentencing. If a taxpayer enters a guilty plea that is later ratified by the judge, the conviction is entered at the date of ratification. However, ratification will often not occur until sentencing. If a taxpayer is convicted but discharged, the taxpayer will still be treated as convicted. However, if the taxpayer is discharged without conviction, then a conviction has not been entered and there is no “disqualifying offence” for the purpose of s 141FB.

(c) Generally, s 141FB applies separately to each tax type, such as PAYE, income tax and FBT. Therefore, a penalty imposed in relation to one tax type does not preclude a previous behaviour reduction for a later shortfall penalty relating to a different tax type. However, if the taxpayer is convicted of a “disqualifying offence” under paragraph (a) of that term’s definition in s 141FB(3), then a later shortfall penalty for any tax type cannot be reduced by 50 per cent.

(d) If a taxpayer has not been convicted of a “disqualifying offence” and is not liable for a “disqualifying penalty”, a current penalty for evasion under s 141E(1) will be reduced by 50 per cent. However, a current penalty for evasion will not be reduced by 50 per cent under s 141FB(1) if the taxpayer is liable to pay an earlier shortfall penalty for evasion that:

(i) Relates to the same tax type;
(ii) Is not reduced for voluntary disclosure; and
(iii) Relates to a tax position taken from 26 March 2003 and before the date of the tax position to which the current penalty relates.

(e) An earlier shortfall penalty for evasion that is reduced for voluntary disclosure is not a “disqualifying penalty”. Therefore, it will not affect the taxpayer’s eligibility to the 50 per cent reduction of the current penalty for evasion.

(f) The imposition of a shortfall penalty for evasion will affect the taxpayer’s eligibility for the 50 per cent reduction of later shortfall penalties in some cases. That is, if the shortfall penalty for evasion is not reduced for voluntary disclosure, any later shortfall penalty for evasion for the same tax type will not be reduced by 50 per cent under s 141FB(1). There is no specified time period in respect of a shortfall penalty for evasion in these cases. However, the specified time period will apply in cases where the later shortfall penalty is imposed under any of ss 141A to 141D. For example, a later penalty imposed for lack of reasonable care under s 141A for an income tax shortfall will be reduced by 50 per cent under s 141FB(2) if the previous shortfall penalty for evasion, that is not reduced for voluntary disclosure, relates to an income tax position taken outside the four-year specified time period.

(g) For the purpose of the SPS, an “investigation” means any examination of a taxpayer’s financial affairs verifying that the taxpayer has paid the correct amount of tax and is complying with the tax laws. Clear wording will be used in any communication to taxpayers when a decision to investigate has been made. Requests for information to enable the CIR to decide whether to investigate are not themselves part of an investigation. Examples of investigation activities include:

(i) Income tax, GST and payroll checks (eg capital/revenue discrepancies and GST on real property transactions);
(ii) Payroll, GST, and FBT registration checks; and
(iii) Any other types of review by Inland Revenue.

Example 1:
A taxpayer takes a tax position on 1 May 20X3. Following an Inland Revenue investigation, a current penalty for evasion is imposed on 1 August 20X3 for an income tax shortfall for the 20X2 tax year. The taxpayer has not been convicted of a...
“disqualifying offence”. However, the taxpayer was liable to pay a shortfall penalty for evasion for an income tax position taken on 1 June 20X1. The shortfall penalty for evasion for the tax position taken on 1 June 20X1 is a “disqualifying penalty” because:

(a) It is for the same tax type as the current penalty;
(b) It is not reduced for voluntary disclosure by the taxpayer; and
(c) It relates to a tax position taken after 26 March 20X1 and before the date on which the taxpayer takes the tax position to which the current penalty relates (ie 1 May 20X3).

The current penalty will not be reduced by 50 per cent under s 141FB(1) because the taxpayer is liable to pay a “disqualifying penalty”.

<table>
<thead>
<tr>
<th>Date</th>
<th>Tax Position</th>
<th>26 Mar X1</th>
<th>26 Jun X3</th>
<th>1 May X3</th>
<th>1 Aug X3</th>
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<tbody>
<tr>
<td>Clean slate</td>
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Example 2:
A taxpayer takes an income tax position on 31 July 20X5 and a current penalty for gross carelessness under s 141C is imposed on 31 August 20X5. Following a previous Inland Revenue investigation the taxpayer was liable to pay a shortfall penalty for taking an abusive tax position imposed under s 141D on 30 September 20X1 for an income tax position taken on 1 September 20X1. The shortfall penalty was not reduced for voluntary disclosure but was reduced for previous behaviour. The taxpayer is not convicted of a “disqualifying offence”. The shortfall penalty for taking an abusive tax position is a “disqualifying penalty” because:

(a) It is for the same tax type as the current penalty;
(b) It is not reduced for voluntary disclosure by the taxpayer; and
(c) It relates to a tax position taken after 26 March 20X1, within the four-year specified time period (1 August 20X1 to 31 July 20X5) and before the date of the taxpayer’s tax position to which the current penalty relates (ie 31 July 20X5).

<table>
<thead>
<tr>
<th>Date</th>
<th>Tax Position</th>
<th>26 Mar X1</th>
<th>1 Aug X1</th>
<th>1 Sep X3</th>
<th>30 Sep X1</th>
<th>31 Jul X5</th>
<th>31 Aug X5</th>
</tr>
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<tbody>
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<td>Clean slate</td>
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4-year satisfactory behaviour period
Penalties and Interest

1110.140  Reduction in penalty for voluntary disclosure of tax shortfall

[TAA, s 141G]

A shortfall penalty under any of ss 141A to 141EB may be reduced if, in the CIR’s opinion, the taxpayer makes a full voluntary disclosure to the CIR of all the details of the tax shortfall, either:

(a) Before the taxpayer is first notified of a pending tax audit or investigation (referred to as “pre-notification disclosure”); or

(b) After the taxpayer is notified of a pending tax audit or investigation, but before the CIR starts the audit or investigation (referred to as “post-notification disclosure”).

The shortfall penalty is reduced as follows:

<table>
<thead>
<tr>
<th>Type of disclosure</th>
<th>Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-notification disclosure, where the shortfall penalty is for not taking reasonable care, taking an unacceptable tax position, or unacceptable interpretation</td>
<td>100%</td>
</tr>
<tr>
<td>Pre-notification disclosure, for any other type of shortfall penalty</td>
<td>75%</td>
</tr>
<tr>
<td>Post-notification disclosure</td>
<td>40%</td>
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</tbody>
</table>

The CIR may specify the information required for a full voluntary disclosure and the form in which it must be provided.

Standard practice statement INV-260 defines Inland Revenue actions that constitute an audit or investigation and how a taxpayer will know that they have, in fact, been notified of a pending audit or investigation. According to the statement, any Inland Revenue examination of a taxpayer’s financial affairs to verify compliance with the tax laws is an audit. When Inland Revenue notifies a taxpayer that a tax audit or investigation is pending, this fact will, according to the statement, be brought clearly to the attention of the taxpayer. Such notification, which can only be given by the Inland Revenue, may be verbal or in writing. Inland Revenue considers that the actual words “audit” and “investigation” are not required to be used in the notification. Terms such as review, verify, check, or inspection could also be used. Thus, Inland Revenue believes that the statement “I am writing to inquire about a claim made in your … return” constitutes notification for the purposes of s 141G of the TAA [see TIB vol 12:2 (February 2000) at 58-60]. Taxpayers who are in any doubt as to whether an Inland Revenue communication constitutes notification should seek professional advice.

An audit or investigation starts at the earlier of:

(a) The end of the first interview an officer of Inland Revenue has with the taxpayer or the taxpayer’s representative after the taxpayer is notified as above; and

(b) The time when:

(i) An officer of Inland Revenue inspects information (including books or records) of the taxpayer after the taxpayer is notified as above; and

(ii) The taxpayer is notified of the inspection.

The CIR’s policy on voluntary disclosure is set out in TIB vol 8:7 (October 1996) at 23.

Inland Revenue’s guidelines for making voluntary disclosures are set out in standard practice statement INV-251, which replaced INV-250 from 1 May 2002 [see TIB vol 14:4 (April 2002) at 16-19]. The only significant difference between the two statements is in relation to prosecution following voluntary disclosure. Inland Revenue’s practice from 1 May 2002 is that taxpayers who have made a post-notification disclosure may be prosecuted in cases of evasion and fraud. Taxpayers making pre-notification disclosures will continue to be immune from prosecution in all cases. Inland Revenue’s practice prior to 1 May 2002 was not to prosecute any taxpayer who made a voluntary disclosure.

The following is an extract of relevant parts of INV-251.
1110.140(1)

(1) **Voluntary disclosure methods**

Taxpayers can make a voluntary disclosure in any one of the following ways:

(a) Visiting an Inland Revenue office;
(b) Telephoning an Inland Revenue office;
(c) Sending a letter, fax, or email to an Inland Revenue office; or
(d) During an interview with an Inland Revenue officer.

If a taxpayer makes a voluntary disclosure by visiting or telephoning Inland Revenue, as much information as possible will need to be provided by the taxpayer. Any officer is able to record a voluntary disclosure when a taxpayer visits or contacts Inland Revenue. Taxpayers making voluntary disclosures will be asked to sign a form setting out the disclosures.

If a voluntary disclosure is received in writing between the time of first notification of an audit and the first interview, it will be referred to the auditor who is conducting the audit or investigation. The auditor will incorporate this as correspondence relating to the audit or investigation. Acknowledgment will be made to the taxpayer that the disclosure has been received.

Where a disclosure is made during the first interview, the auditor will consider whether the disclosure is complete and reveals all the relevant information necessary to ascertain the correct tax position.

(2) **Notification of an audit**

A taxpayer is deemed to have been notified of a pending tax audit or investigation, or that the tax audit or investigation has started, if any one of the following is notified:

(a) The taxpayer;
(b) An officer of the taxpayer;
(c) A shareholder of the taxpayer, if the taxpayer is a close company;
(d) A tax adviser acting for the taxpayer;
(e) A partner in a partnership; or
(f) A person acting for, or on behalf of, or as a fiduciary of the taxpayer.

An officer of the taxpayer includes a director, secretary, receiver, or liquidator, but not an employee.

Time of notification is the earlier of the date of receipt by the taxpayer or agent of the written advice, or the time of a telephone call advising the commencement of the audit or investigation.

If the exact time of receipt of the written notice becomes crucial, it will be ascertained from the expected time for the mail to reach its destination as prescribed by s 14(2) of the TAA. Any telephone call advising of an audit or investigation will be followed up by written advice as soon as possible.

In the case of unannounced visits, the time of first contact with the taxpayer is the date of notification.

If the taxpayer does not attend the first interview, but instead sends a representative, the taxpayer cannot claim the benefit of a post-notification disclosure for any additional tax shortfall revealed after the interview. This is the case even if the agent was not given any information by the taxpayer with which to make a disclosure.

An audit of a parent company, or a subsidiary of that company, may necessitate the audit of other subsidiaries within the group. In such cases, disclosure would depend on which entity had been notified. If the parent company had received notification that the audit was restricted to that entity, then any disclosure made by the subsidiary is voluntary disclosure prior to notification of an audit. However, if another company in the group has been notified that the audit is being extended, any disclosure made by that other company would be considered a disclosure after notification of an audit.

When a company has a branch or branches, they are considered to have been notified at the same time as the company, as they are part of the company and not separate entities.
(3) **Full disclosure**

Any voluntary disclosure will initially be considered as a request for an amendment to an assessment, subject to the applicable time bar [see 60.70]. The disclosure must be full and complete. It is not up to Inland Revenue to elicit the required information from the taxpayer. This does not necessarily mean disclosing the discrepancies to the last dollar, but does require providing enough information to enable the Inland Revenue officer to make an assessment. Each case is considered on its own merits.

If a taxpayer is unable to provide full details at the first point of contact, Inland Revenue will allow the taxpayer reasonable time to obtain more information. The time period for obtaining this information is negotiable. Once this information is provided and the disclosure is considered full and complete, the date of the voluntary disclosure will be the date of the first point of contact.

To satisfy full and complete disclosure, the taxpayer must provide the following minimum details:

(a) Taxpayer’s name, trade name, IRD number, address, date of birth or incorporation, contact telephone number, and contact times;

(b) The nature of the errors or omissions;

(c) An explanation as to why the errors or omissions occurred;

(d) Adequate information to enable an assessment of the tax shortfall to be made;

(e) A declaration signed by the taxpayer, if possible; and

(f) Further information as is necessary to make an assessment.

If all this information is not provided, Inland Revenue will consider on a case-by-case basis whether the information provided is sufficient to satisfy the full and complete disclosure requirements. In doing so, Inland Revenue will have regard to the taxpayer’s reasons for not making the specified information available.

(4) **More than one tax shortfall**

Each tax shortfall is considered separately. If there is more than one tax shortfall, one being the subject of voluntary disclosure and the other being detected by an audit, the shortfall detected by the audit will not come within the voluntary disclosure regime.

If the items are identical or similar, they will be treated as one tax shortfall. Therefore, for a full and complete voluntary disclosure, all items will need to be disclosed prior to the end of the first interview. If one of the items is not disclosed until after the first interview, this will result in the taxpayer not satisfying the requirements of a full and complete disclosure.

(5) **Disclosure of another tax type**

If an audit is being carried out on one tax type and the taxpayer makes a voluntary disclosure regarding another tax type, and the taxpayer has not been notified that the other tax type is being audited, the taxpayer will qualify for voluntary disclosure prior to notification of an audit as long as the disclosure meets all other requirements.

(6) **Disclosure of another period**

It is common for a notice of intention to carry out an audit to state that a particular year or period is to be audited, but previous years or periods may be looked at if necessary. The year or period referred to only is examined in the first instance. If the taxpayer has not been advised that an earlier year or period is being examined, the taxpayer is able to make a pre-notification disclosure for that year or period.

(7) **Disclosure where Inland Revenue already knows of the shortfall**

Where the information provided is required by law or Inland Revenue knows there is a tax shortfall and has verification of that shortfall, the taxpayer cannot make a voluntary disclosure. An example of this is when an employer files their employer monthly schedule without an accompanying payment. The employer cannot voluntarily disclose the non-payment of the PAYE as Inland Revenue will know that payment has not been made.
(8) Disclosure forms
Where possible it is desirable for the protection of both the taxpayer and Inland Revenue that disclosures be in writing and signed by the taxpayer. A voluntary disclosure form (IR282A) is available for this purpose. However, Inland Revenue will accept other written and verbal disclosures without the need for the taxpayer to complete the form.

(9) Prosecution and publication of name
If a voluntary disclosure is full and complete:
(a) Inland Revenue will not consider prosecution action for pre-notification disclosures.
(b) In post-notification cases, prosecution may be considered in cases of evasion or similar offences.
(c) The taxpayer’s name will not be published in the New Zealand Gazette.

1110.145 Reduction in penalty for disclosure of unacceptable tax position [TAA, s 141H]
A shortfall penalty payable by a taxpayer for taking an unacceptable tax position or an abusive tax position may be reduced by 75 per cent if, in the CIR’s opinion, the taxpayer makes adequate disclosure of the tax position at the time the tax position is taken.
The CIR will specify the type of information required for adequate disclosure and the form in which the information must be provided. Disclosure must be made on a specified form. The following information is required in order to satisfy the requirement of adequate disclosure:
(a) Taxpayer’s details (name, trade name, IRD number, address, date of birth, contact telephone, and contact times);
(b) Overview of the position taken;
(c) Interpretation of case law on the subject, contents of any tax opinions, legal articles and related material;
(d) Any relevant Inland Revenue public ruling;
(e) A calculation, if necessary, to show the position and how it was arrived at; and
(f) A declaration and signature by taxpayer.
The disclosure form must be filed with the return in which the particular tax position has been taken.
If the tax return is filed electronically, the specified form will need to be sent to Inland Revenue separately.
The CIR’s policy on disclosure is set out in TIB vol 8:7 (October 1996) at 24.

1110.150 Reduction in penalty for temporary shortfall [TAA, s 141I]
A promoter penalty or a shortfall penalty payable by a taxpayer for lack of reasonable care, unacceptable interpretation, gross carelessness, or taking an abusive tax position must be reduced by 75 per cent if and to the extent that the tax shortfall is temporary.
A tax shortfall is a temporary tax shortfall for the return period if, when the CIR considers the assessment of a shortfall penalty, the CIR is satisfied that:
(a) The tax shortfall has been or will be, in an earlier or later return period, permanently reversed or corrected:
   (i) Before the end of the four-year period beginning after the day on which the taxpayer took the tax position;
   (ii) With the effect that the taxpayer pays or returns for the relevant return periods the correct total amount of tax (excluding penalties and interest) in respect of the tax position; and
   (iii) As a result of actions taken by the taxpayer or by the operation of law or circumstances;
(b) No tax shortfall will arise in a later return period in respect of a similar tax position; and
(c) No arrangement exists with the purpose or effect of creating a tax deferral or advantage related to the tax position for another return period.

The CIR’s policy on temporary shortfalls is set out in TIB vol 8:7 (October 1996) at 25. The CIR accepts that a shortfall has been permanently reversed if it appears from the taxpayer’s actions that steps taken will remedy the tax shortfall, or the matter will reverse itself through operation of law or circumstances. In order for the temporary shortfall reduction to apply, it is not always necessary for the return in which a shortfall is reversed to have been filed before an audit or investigation commences. Inland Revenue will accept that a reversal has occurred if satisfied that the reversal would have been made in the next return. This will apply mainly to GST returns [see TIB vol 11:8 (September 1999) at 22-24].

1110.155 Limit on reduction of shortfall penalty [TAA, s 141J]

A shortfall penalty cannot be reduced for both voluntary disclosure [TAA, ss 141G and 141H] and because of a temporary shortfall [TAA, s 141I]. A special penalty reduction rule applies to a shortfall penalty if:

(a) A taxpayer makes a voluntary disclosure (from 17 May 2007);
(b) The shortfall penalty is payable in respect of a temporary tax shortfall; and
(c) The shortfall would otherwise be reduced under s 141G or 141H of the TAA.

If the above conditions are met, the shortfall penalty is reduced by 100 per cent if:

(a) The shortfall penalty is for not taking reasonable care, for taking an unacceptable tax position, or for taking a tax position involving an unacceptable interpretation of a tax law; and
(b) The tax shortfall is voluntarily disclosed before notification of a pending audit or investigation by Inland Revenue.

In any other circumstances, the shortfall penalty is reduced by 75 per cent. For voluntary disclosures made before 17 May 2007, a shortfall penalty could be reduced only once, by 75 per cent in all cases.

1110.160 Shortfall penalty not to exceed $50,000 [TAA, s 141JAA]

A shortfall penalty for not taking reasonable care or for taking an unacceptable tax position may not exceed $50,000 if:

(a) The taxpayer voluntarily discloses the shortfall under s 141G of the TAA; or
(b) The CIR determines the shortfall no later than the later of:

(i) Three months after the due date for the return to which the shortfall relates; and
(ii) One return period (if no more than six months).

The $50,000 limit does not apply if the shortfall penalty has been increased for obstruction under s 141K of the TAA.

1110.165 Increased penalty for obstruction [TAA, s 141K]

The CIR may increase a shortfall penalty payable under any of ss 141AA to 141EB by 25 per cent if the taxpayer obstructs the CIR in determining the taxpayer’s correct tax position.

(1) Actions that are not obstruction

A taxpayer is entitled to:

(a) Exercise legal rights (accordingly, obstruction does not include asserting the right to legal privilege);
(b) Contest an assessment (the obstruction offences are not intended to discourage taxpayers from using legal processes in the course of any disagreement with Inland Revenue);
(c) Maintain an opinion contrary to that of Inland Revenue.

(2) Examples of obstruction

Examples include:

(a) Refusing reasonable access to business premises;
(b) Destroying relevant records;
(c) Successful prosecution of a taxpayer for a TAA, s 17 offence of failing to provide records or information requested;
(d) Lying at an interview;
(e) Falsifying details in a statement of assets and liabilities (IR110);
(f) Deliberate delay by the taxpayer to frustrate Inland Revenue’s inquiries.
The CIR’s policy on obstruction is set out in TIB vol 8:7 (October 1996) at 24, 25.

1110.170 **Shortfall penalties: disputes resolution**

A taxpayer has the right to disagree with the CIR’s decision to impose shortfall penalties.

The CIR will raise the issue of shortfall penalties as soon as practicable, which in most cases is at the time the substantive issues are being discussed. A notice of proposed adjustment (NOPA) will be issued before any assessment or adjustment of shortfall penalties unless there is full agreement with the taxpayer before the issue of the NOPA or a Court has directed the adjustment.

If the taxpayer cannot resolve the issues in the NOPA with the Inland Revenue officer who initially dealt with the case, the matter will be referred to Inland Revenue’s Adjudication Unit for further consideration before any assessments are issued [see 260.185].

A taxpayer who still disagrees with the assessment after adjudication has the normal rights of review through the Courts [see TIB vol 8:7 (October 1996) at 26].

When Inland Revenue and a taxpayer have agreed on the adjustments to be made to a return (eg following an Inland Revenue audit), it is Inland Revenue’s practice to reach agreement with the taxpayer on any shortfall penalties at the same time and to include these penalties on the agreed adjustment form. If the taxpayer disagrees with the shortfall penalties or it is otherwise inappropriate to include the penalties on the form (eg because Inland Revenue is prosecuting the taxpayer), Inland Revenue will inform the taxpayer that shortfall penalties may still apply. The taxpayer then knows what their potential total liability is likely to be at the time the agreement is reached [see TIB vol 13:9 (September 2001) at 89].

1110.175 **Shortfall penalties for failure to deduct or account for PAYE**

Employers who fail to deduct or account for PAYE are potentially liable for a shortfall penalty. In TIB vol 12:5 (May 2000) at 51-53, Inland Revenue outlined the factors it would consider when deciding whether to impose shortfall penalties and provided a number of examples of situations in which such penalties may and may not be imposed.

Where a PAYE shortfall occurs, a number of factors are considered by Inland Revenue to establish whether shortfall penalties should be imposed:

(a) The employer’s knowledge of the trust money status of PAYE;
(b) The processes in place to ensure that returns are correct, filed on time, and PAYE is accounted for on time;
(c) Who is responsible for drawing up deduction details and forwarding payment by the due date;
(d) The length of time the taxpayer has been employing staff, and their awareness of the obligation to deduct PAYE and make payments by the due date;
(e) Whether the taxpayer was aware that PAYE had not been accounted for by the due date and that an offence was being committed;
(f) Whether steps were taken to rectify the situation after the taxpayer became aware that payment had not been made;
(g) Reasons why the deductions were not paid by the due date and who is responsible to ensure payment is made; and
(h) How the unpaid deductions were applied by the taxpayer.
See TIB vol 12:5 (May 2000) at 51-53 for examples of how these factors would be applied in specific situations.

1110.180 Shortfall penalty if non-resident contractor has total tax relief

[TAA, s 141AA]

If a person fails to make a required tax deduction from a schedular payment made to a non-resident contractor (who does not hold a certificate of exemption), the payer is liable to pay a shortfall penalty of $250 per return period if the non-resident contractor is not liable to pay income tax on the contract payment (because of a DTA or otherwise). The maximum penalty is $1,000 per return period for which an employer monthly schedule is required.

Even though a non-resident contractor may qualify for total tax relief under a DTA, the New Zealand employer is still required to withhold tax from contract payments unless the non-resident contractor holds a certificate of exemption. The penalty aims to ensure that employers deduct tax from contract payments when the non-resident contractor has not obtained a certificate of exemption.

If a penalty is imposed under s 141AA, a shortfall penalty is not also payable under s 141 of the TAA on the same shortfall.

1110.185 Tax shortfalls — calculation

[TAA, s 141]

A tax shortfall calculation, to be made by the CIR, is required each time a taxpayer is liable to pay a shortfall penalty. This does not apply to a shortfall penalty imposed under s 141AA of the TAA.

A separate tax shortfall calculation is required for each return period, for each tax type, and for each tax position taken by a taxpayer.

“Return period” is defined as:

(a) The period covered by a tax return, or which would be covered by a tax return if one were provided;

(b) For a tax return that relates to a transaction, the time within which the transaction must be returned [TAA, s 3(1)].

Item (b) of the definition ensures that the shortfall penalties apply as intended to transaction-based taxes (eg cheque duty), which do not have an identifiable period in the same way as income tax and GST.

If a taxpayer is liable to pay one or more shortfall penalties for the same tax type in a return period, and the taxpayer’s liability to the tax is overstated in one or more respects, the tax shortfall is calculated by:

(a) In the case of one tax shortfall, setting off the tax effects of the overstatements against the understatement; and

(b) In the case of more than one tax shortfall, setting off the tax effects of the overstatements pro-rated against the understatements.

If:

(a) A taxpayer’s tax position in respect of a tax type (“tax one”) is adjusted by the CIR in a return period, and the tax effect of the adjustment is a tax shortfall; and

(b) As a result or consequence of the adjustment, the CIR also adjusts the taxpayer’s tax position in respect of another type of tax (“tax two”) in the same return period, and the tax effect of the further adjustment is an entitlement to a refund or to an increased refund of tax,

the CIR may, for the purpose of imposing a penalty, treat an amount up to the refund, or increased refund, of tax two as though it were tax one paid by the taxpayer in the return period, and in so doing reduce the tax shortfall for tax one. If two types of tax have different return periods, the CIR may, for the purpose of determining a tax shortfall, specify that part of one or more return periods for one of the tax types is to be treated as the same return period for the other tax type.

If:

(a) A taxpayer’s tax position in respect of a tax type in a return period is adjusted by the CIR, and the tax effect of the adjustment is a tax shortfall; and
(b) Linked to the adjustment, the CIR adjusts another taxpayer’s tax position in respect of the same tax type in the same return period, and the tax effect of the further adjustment is an entitlement to a refund or an increased refund of tax or a reduction in tax to pay; and

(c) The two taxpayers are “associated persons” [as defined in subpart YB],

the CIR may, for the purpose of imposing a penalty, treat an amount up to the refund, or increased refund, or reduction, of tax as though it were tax paid by the taxpayer referred to in paragraph (a) in the return period, and in so doing reduce that taxpayer’s tax shortfall.

The CIR may exercise this discretion if the associated person has a different return period from the taxpayer’s, provided the associated person’s return period overlaps the taxpayer’s, and the taxpayer’s tax position is not an abusive tax position and does not involve evasion or a similar act.

For the purposes of reducing taxpayer A’s tax shortfall (thus reducing the shortfall penalty), the CIR may treat an amount that is less than or equal to taxpayer B’s refund amount as an amount of tax paid by taxpayer A if all of the following conditions are met:

(a) The CIR makes an adjustment to a taxpayer’s tax position (taxpayer A) for a tax credit relating to internal software development under s LH 2;

(b) The adjustment in (a) results in a tax shortfall;

(c) The CIR makes an adjustment to another taxpayer’s tax position (taxpayer B) for a tax credit relating to internal software development under s LH 2;

(d) The adjustment in (c) is for the same tax year as the adjustment relating to taxpayer A;

(e) The adjustment in (c) results in an entitlement to an amount of refund or increased refund of tax (the refund amount) for taxpayer B;

(f) For the period to which the adjustments relate, taxpayer A and taxpayer B are members of the same internal software development group; and

(g) The tax credits described in item (a) and (c), relate to expenditure or depreciation loss under subpart LH incurred while taxpayer A and taxpayer B are members of the same internal software development group.

The CIR may treat the companies in a wholly-owned group as if they were a single taxpayer for the purposes of determining a tax shortfall.

If:

(a) In a return period, a taxpayer takes a tax position in respect of, or as a consequence of entering into, an arrangement; or in respect of an article, item, or matter; and

(b) In the same return period, the taxpayer takes a similar or identical tax position in respect of, or as a consequence of entering into, a similar or identical arrangement; or in respect of a similar or identical article, item, or matter,

the tax shortfalls arising from the taxpayer’s tax positions are to be aggregated and deemed to be one tax shortfall.

The tax effect of a tax position taken by a taxpayer in a return period is to be calculated having regard to the marginal rate or rates of tax applicable to the taxpayer during the return period and, where the taxpayer has no tax to pay in the return period, the rate of tax or lowest marginal rate of tax that would apply to the taxpayer during the return period, if the taxpayer had tax to pay.

The tax shortfall for a provisional taxpayer in respect of an instalment date is the difference between:

(a) The lesser of:

(i) The amount of provisional tax payable on the instalment date if an estimate had not applied at that instalment date; and
Penalties and Interest

(ii) The amount that would have been payable on that instalment date if the taxpayer’s provisional
tax payable for the tax year had been the taxpayer’s residual income tax liability for the tax
year; and

(b) The amount of provisional tax payable on that instalment date as determined by the estimate applying
as at that instalment date.

For the purposes of determining tax shortfalls, “tax” does not include a civil penalty.

The CIR’s approach to calculating shortfall penalties is set out in TIB vol 8:7 (October 1996) at 26, 27. The
TIB contains two detailed worked examples of the calculation of shortfall penalties, late payment penalties,
and interest on at 27-31.

1110.190 Duty of CIR to report on application of penalties [TAA, s 141L]

The CIR is required, as soon as practicable after the end of each financial year, to report in writing to the
Minister of Finance on the manner in which the shortfall penalties under ss 141A to 141EB of the TAA have
been applied in that financial year. The Minister must lay a copy of the report before the House of
Representatives.

The report for the year ended 30 June 2009 discloses that 5,152 tax shortfall cases were identified. Tax
shortfall penalties were imposed in 1,441 cases. The total number of shortfall penalties imposed in these
1,441 cases was 7,049. The monetary value of the shortfall penalties imposed and the number of impositions
were:

<table>
<thead>
<tr>
<th>Type of shortfall</th>
<th>Total amount</th>
<th>Number of impositions</th>
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</thead>
<tbody>
<tr>
<td>Not taking reasonable care</td>
<td>$1,644,984</td>
<td>2,054</td>
</tr>
<tr>
<td>Unacceptable tax position</td>
<td>$3,400,248</td>
<td>417</td>
</tr>
<tr>
<td>Gross carelessness</td>
<td>$8,058,183</td>
<td>2,609</td>
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<tr>
<td>Abusive tax position</td>
<td>$90,124,418</td>
<td>191</td>
</tr>
<tr>
<td>Evasion</td>
<td>$18,154,131</td>
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</tr>
<tr>
<td>Total</td>
<td>$121,381,964</td>
<td>7,049</td>
</tr>
</tbody>
</table>

1110.195 Use of net losses to pay shortfall penalties [ss IA 3(1), IW 1]

A person who has a tax loss for a tax year can use the tax loss to pay a shortfall penalty for an income tax
liability for the tax year. The taxpayer must notify the CIR by the due date for payment of the penalty. The
election may be in either written or verbal form. The tax loss is used at the time of notification.

“Tax year” includes any part of a tax year taken into account for the purposes of carrying forward or grouping
company losses.

The losses used may be either current tax year losses or losses carried forward from a previous tax year.
There is no requirement that the losses must have been incurred since the introduction of the shortfall penalty
rules.

A wholly-owned group of companies may elect to use a tax loss incurred by one company in the group to
pay a shortfall penalty imposed on another company in the group.

Each dollar of net loss used to pay a shortfall penalty counts as an amount equal to:

\[ \$1 \times \text{tax rate} \]

“Tax rate” means the rate of tax, or the lowest marginal rate of tax, that would apply to the person during the
return period to which the tax shortfall relates. For companies, the tax rate is 30 per cent. For individuals,
the tax rate is the lowest marginal tax rate.

Example:

In the case of a company, a loss of $1,000 would be sufficient to pay a penalty of $300 ($1,000 \times 30\%).
Once a tax loss has been used to pay a shortfall penalty, that loss is no longer available for any other use and cannot be carried forward to a later tax year.

(1) CIR’s practice

The CIR’s approach to the use of tax losses to pay shortfall penalties is described in standard practice statement INV-245 [see TIB vol 10:3 (March 1998) at 24, 25]. The following information outlines relevant parts of the statement.

A taxpayer who has no losses carried forward from prior tax years, or has insufficient losses to eliminate both tax and penalty, but who expects to have losses in the current tax year, can elect to use those losses, even though the final loss for the current tax year has not been established.

Losses can only be used to offset against shortfall penalties on income tax shortfalls. They are not available to be offset, for example, against shortfall penalties on PAYE as this is not income tax to the employer.

Losses can only be used to offset income tax penalties as losses are, as defined in the ITA, “available to be offset against assessable income”. Therefore, as penalties which relate to anything other than income tax are not assessable income items, the losses cannot be offset against them.

Losses must be available in the year in which the shortfall penalty is imposed. For example, if adjustments are made to the 1999 return and penalties are imposed in the year 2001, losses must be available in the year 2001.

1110.200 Due date for payment of shortfall penalties [TAA, ss 142B, 142C]

A shortfall penalty is due and payable on the date the CIR notifies the taxpayer to be the due date, unless the tax shortfall is an amount of unpaid tax in which case the penalty is due and payable:

(a) Where no new due date is set, on the date the CIR notifies the taxpayer to be the due date for payment of the penalty (not less than 30 days after the date on which the CIR issues the taxpayer with a notice of assessment for the penalty); or

(b) Where a new due date has been set, on the due date for payment of the unpaid tax.

The due date for payment of a shortfall penalty by an officer of a company under s 141F of the TAA is the due date for payment of the shortfall penalty by the taxpayer.

If the CIR assesses a penalty for not taking reasonable care [s 141A] after cancelling (under s 141KB) a shortfall penalty for taking an unacceptable tax position [s 141B], the due date for payment for the s 141A penalty is the time the s 141B penalty was cancelled [see 1110.90]. Note: s 141KB was repealed for tax positions taken on or after 1 April 2008.

1110.205 Due date for repayment of excess refund or credit of tax [TAA, ss 142D]

Where a credit of tax has been allowed or credited under a tax law in excess of the correct amount, and the excess tax credit has been paid as a refund, the amount of the excess is repayable on the later of:

(a) The day specified by the CIR in the notice to the person requiring payment of the refund; and

(b) Thirty days after the date of that notice.

The tax is repayable on the date specified by the CIR in a notice to the taxpayer if:

(a) The CIR refunds too much tax to a taxpayer or credits a taxpayer with the payment of too much tax;

(b) A tax law provides for that tax to be repayable to the CIR on a set date or on a date to be specified by the CIR; and

(c) The CIR considers that applying that tax law may prejudice the CIR’s ability to recover that tax.
1110.210  **Due dates for payment of imputation penalty tax** [TAA, s 142E]

Imputation penalty tax is due and payable on 20 June following the end of the tax year in which the end of year debit balance (giving rise to the liability for the further income tax and the imputation penalty tax) occurred.

1110.215  **Due date for payment of deferrable tax** [TAA, s 142F]

Deferrable tax is due and payable on the 30th day after the last day of the period of deferral. Deferrable tax is tax (including GST) that has been assessed as payable, and which the taxpayer has challenged under Part 8A of the TAA [see 260.105].

1110.220  **Criminal penalties**

The following types of offences are criminal offences.

<table>
<thead>
<tr>
<th>TAA section</th>
<th>Offence</th>
<th>Staples paragraph</th>
</tr>
</thead>
<tbody>
<tr>
<td>143</td>
<td>Absolute liability offences</td>
<td>1110.225</td>
</tr>
<tr>
<td>143A</td>
<td>Knowledge offences</td>
<td>1110.230</td>
</tr>
<tr>
<td>143B</td>
<td>Evasion or similar offences</td>
<td>1110.235</td>
</tr>
<tr>
<td>143C</td>
<td>Failure of an Inland Revenue officer to maintain secrecy</td>
<td>1110.240</td>
</tr>
<tr>
<td>143D</td>
<td>Failure of other persons to maintain secrecy</td>
<td>-</td>
</tr>
<tr>
<td>143E</td>
<td>Failure to maintain secrecy of restricted information</td>
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1110.225  **Absolute liability offences** [TAA, s 143]

The following offences are absolute liability offences under the TAA:

(a)  Failure to keep the documents required to be kept by a tax law;

(b)  Failure to provide information (including tax returns and tax forms) to the CIR or any other person when required to do so by a tax law;

(c)  Failure to provide a tax invoice when required to do so under the GSTA 1985; or

(d)  Failure to apply for registration for GST when required to do so under the GSTA 1985.

The term “tax return” includes income statements.

“Document” means:

(a)  A thing that is used to hold, in or on the thing and in any form, items of informations;

(b)  An item of information held in or on a thing referred to in (a);

(c)  A device associated with a thing referred to in (a) and required for the expression, in any form, of an item of information held in or on the thing.

A person cannot be convicted for failing to provide information (other than tax returns and tax forms) to the CIR if the person proves that, at the time they were required to provide the information:

(a)  They did not have that information in their knowledge, possession or control; and
(b) The information was not in the knowledge, possession or control of a non-resident who the person directly or indirectly controls.

The penalty for an absolute liability offence is:

(a) The first time the person is convicted in relation to a particular type of offence, a fine not exceeding $4,000;
(b) The second time the person is convicted of the same type of offence, a fine not exceeding $8,000; or
(c) On every other occasion the person is convicted of the same type of offence, a fine not exceeding $12,000.

In Beazley v Inland Revenue Department (2003) 21 NZTC 18,287 (HC), the High Court considered an appeal against penalties imposed on a taxpayer in the District Court for failure to file 17 income tax and GST returns. The taxpayer was fined a total of $3,700 by the District Court. The fines comprised: $150 for each GST return not filed; $250 for each income tax return not filed; and $650 court costs. The High Court quashed the fines and imposed a fine of $50 in respect of each of the 17 convictions, totalling $1,500 (including costs). Although $300 to $400 was a reasonable starting point for each offence, the totality principle had to be considered where there were multiple offences. Fisher J considered the taxpayer’s circumstances, which included: this was a first offence; business difficulties had affected the taxpayers personal life and health; the tax agent (who was also suffering personal difficulties and ill health) let the taxpayer down; and the taxpayer had liquidity problems.

In Smallridge v Department of Inland Revenue HC Auckland CRI-2004-404-342, 5 October 2004, the High Court also applied the totality principle and reduced total fines from $10,060 to $2,220 for failing to file three income tax returns and 46 GST returns.

1110.230 Knowledge offences [TAA, ss 143A, 147B]

The following offences are knowledge offences:

(a) Knowingly failing to keep the documents required to be kept by a tax law;
(b) Knowingly failing to provide information (including tax returns and tax forms) to the CIR or any other person when required to do so by a tax law;
(c) Knowingly providing altered, false, incomplete, or misleading information (including tax returns and tax forms) to the CIR or any other person in respect of a tax law or a matter or thing relating to a tax law;
(d) Knowingly applying or permitting the application of the amount of a deduction or withholding of tax, made or deemed made under a tax law, for any purpose other than in payment to the CIR;
(e) Knowingly failing to make a deduction or withholding of tax required to be made by a tax law; or
(f) Knowingly issuing two tax invoices in respect of the same taxable supply.

The term “tax return” includes income statements.

A person cannot be convicted for knowingly failing to provide information (other than tax returns and tax forms) to the CIR if the person proves that at the time the person was required by the CIR to provide the information:

(a) The person did not have the information in their knowledge, possession or control; and
(b) No non-resident, controlled directly or indirectly by the person [see 790.30], had the information in their knowledge, possession or control.

A person cannot be convicted for knowingly applying or permitting the application of an amount of withholding or deduction of tax for a purpose other than in payment to the CIR, if the person satisfies the Court that the amount of the deduction or withholding has been accounted for, and that the person’s failure to account for it within the prescribed time was due to illness, accident, or other cause beyond the person’s control. For these purposes, the term “withholding or deduction of tax” includes:

(a) A PAYE income payment;
(b) A combined tax and earner-related payment;
(c) An amount of tax withheld for resident passive income, non-resident passive income, or an employer’s superannuation contribution; and
(d) A deduction of KiwiSaver contribution.

The above defences against conviction are only available if the taxpayer has actually paid the outstanding tax deduction to Inland Revenue (ie after the due date). It is not sufficient to merely furnish the relevant return. The words “accounted for” implicitly require that the amount in question has been paid: *Flyger v Commissioner of Inland Revenue* (2004) 21 NZTC 18,431 (HC).

A person who is convicted for knowingly applying or permitting the application of a deduction or withholding of tax for any purpose other than in payment to the CIR, is liable for each conviction for that type of offence to imprisonment for a term not exceeding five years, a fine not exceeding $50,000, or both, unless the offence relates to:

(a) Section 157 of the TAA (which deals with the deduction of income tax from payments due to tax defaulters);
(b) Section 43 of the GSTA 1985 (which deals with the deduction of GST from payments due to tax defaulters); or
(c) Another tax law specifying obligations in relation to withholdings or deductions of tax that operates by reference to s 157 of the TAA.

A person who is convicted for knowingly failing to provide information to the CIR, or for knowingly providing altered, false, incomplete, or misleading information to the CIR, relating to information required to be provided under s 59 of the TAA (the disclosure of information about trusts with non-resident trustees) or s 61 of the TAA (the disclosure of an interest in a foreign investment fund) is liable to a fine not exceeding $50,000.

In all other cases, the penalty for a knowledge offence is:

(a) The first time the person is convicted for a particular type of offence, a fine not exceeding $25,000; and
(b) On every other occasion the person is convicted for the same type of offence, a fine not exceeding $50,000.

In *Brown v Inland Revenue Department* (2001) 20 NZTC 17,001 (HC), an appeal hearing confirmed the imposition, under s 143A(1)(b) of the TAA, of a fine of $5,000 on a taxpayer for knowingly failing to provide information to the CIR. The taxpayer had failed to respond to a request for information by the CIR.

(1) **Directors and officers of corporate resident foreign trustees [TAA, s 147B]**

If a company that is a resident foreign trustee [see 1210.20] commits a knowledge offence under s 143A of the TAA, a natural person who is a director or officer of that company also commits an offence if:

(a) The person, if not a director, is in a position in the company allowing significant influence over the management or administration of the company; and
(b) The offence was caused by:
   (i) An act done or carried out by the person;
(ii) An omission of the person; or
(iii) Knowledge attributable to the person.

1110.235  **Evasion or similar offences** [TAA, s 143B]

The following offences are evasion or similar offences if done so with the following aims:

(a) Knowingly failing to keep the documents required to be kept by a tax law; or

(b) Knowingly failing to provide information (including tax returns and tax forms) to the CIR or any other person when required to do so by a tax law; or

(c) Knowingly providing altered, false, incomplete, or misleading information (including tax returns and tax forms) to the CIR or any other person in respect of a tax law or a matter or thing relating to a tax law; or

(d) Knowingly failing to make a deduction or withholding of tax required to be made by a tax law; or

(e) Pretending to be another person for any purpose or reason relating to a tax law.

The above offences are considered to be evasion or similar offences only when done so:

(a) With the intention of evading the assessment or payment of tax by the person or any other person under a tax law;

(b) To obtain a refund or payment of tax in the knowledge that the person is not lawfully entitled to the refund or payment under a tax law; or

(c) To enable another person to obtain a refund or payment of tax in the knowledge that the other person is not lawfully entitled to the refund or payment under a tax law.

A person who evades or attempts to evade the assessment or payment of tax under a tax law commits an offence.

The term “tax return” includes income statements.

The penalty for evasion or a similar offence is imprisonment for a term not exceeding five years, a fine not exceeding $50,000, or both.

The seriousness with which the Courts regard the filing of false tax returns was illustrated in *R v Hunter* (2002) 20 NZTC 17,784 (CA), in which the Court of Appeal reduced from four years to three years six months the sentence of imprisonment imposed on a tax consultant for filing numerous false tax and GST returns over a six-year period. The volume of offending and the loss to Inland Revenue were important indicators of culpability in this case. The sentence was only reduced because of the consultant’s guilty plea and cooperation.

The CIR’s approach to determining the criminal offence of evasion is described in standard practice statement INV-225 [see TIB vol 10:3 (March 1998) at 22-24]. The following information outlines relevant parts of the statement.

(1)  **What is meant by “evasion or similar” offences?**

All offences in this category require the person to have both the knowledge and the necessary “intent” to commit the offence.

Intent is critical to the offence. There must be sufficient evidence to prove “beyond reasonable doubt” that the person not only committed the offence but committed it:

(a) Intending to evade the assessment or payment of the tax by the person or any other person; or

(b) To obtain a refund or payment of tax in the knowledge that the person was not lawfully entitled to the refund or payment; or

(c) To enable another person to obtain a refund or payment of tax in the knowledge that the other person was not lawfully entitled to the refund or payment.

Before a person can be prosecuted for an offence under s 143B(1) of the TAA they must meet two criteria. First, the person must have committed an act which comes within paras (a) to (e), and secondly the person must have committed the act with necessary intent, as required in paras (f) to (h).
(2) **Offence**

Section 143B(2) of the TAA provides that a person who evades or attempts to evade the assessment or payment of tax for themselves or another person under a tax law commits an offence against this Act.

Essentially, if a person evades or attempts to evade the assessment or payment of tax and the act or failure to act does not come within the offences listed in s 143B(1)(a) to (e) of the TAA then prosecution action can be taken under s 143B(2) of the TAA.

(3) **Prosecution**

Section 149(5) of the TAA states that if a shortfall penalty has been imposed on a taxpayer for taking an incorrect tax position, the CIR may not subsequently prosecute the taxpayer for taking the incorrect tax position.

Prosecution does not preclude the CIR from imposing the civil penalty for evasion. It is not necessary for a taxpayer to be prosecuted before a shortfall penalty is imposed, as the standards of proof are different.

(4) **Taxpayer to be advised of intention**

If a prosecution is to be considered, the taxpayer will be advised by letter that prosecution action is being recommended. This will occur at the time the Notice of Proposed Adjustment (NOPA) is issued for the tax shortfall.

If it is intended to prosecute and later impose a shortfall penalty, the taxpayer will be advised that after the prosecution, whether or not the prosecution is successful, the imposition of a shortfall penalty will be considered.

(5) **Consideration of shortfall penalty after unsuccessful prosecution**

Section 149(4) of the TAA states that a shortfall penalty may be imposed after a prosecution, whether or not the prosecution is successful.

If prosecution action for evasion is unsuccessful, a shortfall penalty can still be imposed for evasion or a similar act, because the standard of proof is the balance of probabilities, even though the onus of proof is still on the CIR.

However, the reason why the prosecution was not successful will be considered. If it was dismissed on technical grounds (eg some procedural matters in the prosecution were not complied with), clearly a shortfall penalty can be imposed. If the evidence available to the Court was clearly inadequate, then a shortfall penalty cannot be imposed.

1110.240 **Failure of Inland Revenue officers to maintain secrecy** [TAA, s 143C]

An Inland Revenue officer who fails to maintain secrecy as required by s 81 of the TAA commits an offence [see 1030.20]. The penalty for this offence is imprisonment for a term not exceeding six months, a fine not exceeding $15,000, or both.

1110.245 **Offence in relation to inquiries** [TAA, s 143F]

A person commits an offence if the person:

(a) is summoned under s 18 of the TAA and refuses or wilfully neglects to appear before the District Court Judge or to take oath as a witness before the District Court Judge;

(b) is sworn as a witness at an inquiry under s 18 of the TAA and refuses or wilfully neglects to answer any question put to the person touching upon the subject-matter of the inquiry;

(c) is required to give evidence under s 19 of the TAA and refuses or wilfully neglects to appear before the CIR or authorised officer or to take an oath as witness before the CIR or authorised officer; or

(d) is sworn as a witness at an inquiry under s 19 of the TAA and refuses or wilfully neglects:

(i) to answer any question put to the person touching upon the subject-matter of the inquiry; or
(ii) To produce to the CIR or authorised officer a document required to be produced under s 19(1) of the TAA.

The penalty for this type of offence is:

(a) For the first offence — a fine not exceeding $2,000, or a fine not exceeding $50 for each day of default, or both;

(b) For the second offence — a fine not exceeding $4,000, or a fine not exceeding $100 for each day of default, or both; and

(c) For each subsequent offence — a fine not exceeding $6,000, or a fine not exceeding $150 for each day of default, or both.

1110.250 Offence in relation to Court orders [TAA, s 143G]

It is an offence to fail to comply with a Court order made under s 17A of the TAA [see 790.35]. The penalty for this offence is the same as that which may be imposed under s 112 of the District Courts Act 1947 for offences to which that section applies.

1110.255 Obstruction [TAA, s 143H]

It is an offence to obstruct the CIR or an Inland Revenue officer acting in the lawful discharge of their duties or in the exercise of the CIR’s or officer’s powers under a tax law. The penalty for this offence is:

(a) For the first offence — a fine not exceeding $25,000; and

(b) For each subsequent offence — a fine not exceeding $50,000.

1110.260 Penalties for offences for which no specific penalty imposed [TAA, s 145]

The penalty for any offence for which no specific penalty is prescribed is:

(a) For the first offence of its type — a fine not exceeding $15,000; and

(b) For each subsequent offence of the same type — a fine not exceeding $25,000.

1110.265 Offences of employees and officers [TAA, s 147]

An employee, agent, or officer of a body corporate commits an offence if:

(a) The body corporate commits an offence (the “principal offence”); and

(b) The principal offence:

(i) Was caused by an act done or carried out by, or by an omission of, or through knowledge attributable to, the employee, agent, or officer; or

(ii) Is evasion committed by the employee, agent, or officer.

The employee, agent, or officer who does or carries out the act or omission, or has the knowledge or intent referred to above, is liable on conviction for up to the same maximum fine or term of imprisonment, or both, that could apply to an individual, if an individual had committed the principal offence.

A natural person (eg an employee of the corporate trustee) is not liable for an offence under s 147 of the TAA in relation to an offence for which a corporate resident foreign trustee is liable under s 147B of the TAA [see 1110.230].

An employee or officer of a body corporate includes a person who, by reason of the person’s employment with, or position in relation to, the body corporate, is responsible by law, contract, or otherwise for undertaking an action on behalf of the body corporate.

1110.270 Aiding or abetting [TAA, s 148]

A person who aids, abets, incites, or conspires with another person to commit an offence (the “principal offence”) also commits an offence. A person convicted of aiding, abetting, inciting, or conspiring is liable
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for up to the same maximum fine or term of imprisonment, or both, that could apply to a person who commits the principal offence.

1110.275 **Imposition of civil and criminal penalties** [TAA, s 149]

Each time a taxpayer breaches a tax obligation the taxpayer may be liable to a civil penalty or to a criminal penalty, or to both. Except in the case of a shortfall penalty under s 141ED of the TAA for filing an employer monthly schedule late, a taxpayer is liable to only one shortfall penalty for each tax shortfall. If a taxpayer could, apart from this restriction, be liable to more than one shortfall penalty for a tax shortfall, the highest shortfall penalty is to be imposed.

The CIR may assess and impose civil penalties after a taxpayer has been prosecuted for an offence under this Act, whether or not the prosecution is successful.

If a shortfall penalty, other than a shortfall penalty under s 141ED of the TAA for filing an employer monthly schedule late, has been imposed on a taxpayer for taking an incorrect tax position, the CIR may not subsequently prosecute the taxpayer for taking the incorrect tax position.

1110.280 **Standard of proof and onus of proof** [TAA, s 149A]

The standard of proof in civil proceedings relating to the imposition of penalties is *the balance of probabilities*.

The onus of proof in civil proceedings:

(a) Relating to evasion or a similar act to which s 141E of the TAA applies, or to obstruction, rests with the CIR; or

(b) Relating to any other matter or thing, rests with the taxpayer.

The standard of proof in criminal proceedings relating to the imposition of penalties is *beyond reasonable doubt*.

The onus of proof in criminal proceedings relating to any matter or thing rests with the CIR.

The standard of proof for the purposes of an application for a Court order under s 17A of the TAA is the *balance of probabilities*.

The onus of proof for the purposes of an application for a Court order under s 17A of the TAA rests with the CIR.

1110.285 **Proceedings for offences**

Procedural matters relating to proceedings, laying of information, and evidence are set out in ss 149B to 152 of the TAA.

An information for an offence must be laid within 10 years after the end of the year in which the offence was committed. This applies only where the offence relates to a tax law that is a provision of the ITA 2007 or the GSTA 1985, or to an obligation in relation to either of those Acts [TAA, s 150A].

In any proceedings against a person for refusing or failing to provide a tax return or written information or to produce for inspection any documents as and when required by any Act or by the CIR, a certificate signed by the CIR, that the tax return information or documents have not been received at the time required shall, in the absence of proof to the contrary, be sufficient evidence that the person has refused or failed to furnish the return information or documents, as the case may be [TAA, s 150D].

1110.290 **Use of money interest** [TAA, ss 120A-120U]

Use of money interest (UOMI) is not a penalty. The purpose of use of money interest is to:

(a) Compensate the CIR for the loss of use of money through taxpayers paying too little tax, and to compensate taxpayers for the loss of use of money through their paying too much tax; and

(b) To encourage taxpayers to pay the correct amount of tax on time.

If the CIR deducts RWT or NRWT from an interest payment, the interest paid to a taxpayer is the net amount for the purposes of the interest rules [TAA, s 120A].
Interest does not apply to:
(a) Third parties who are required, but fail, to make deductions from payments to taxpayers and forward them to Inland Revenue under s 157 of the TAA, s 43 of the GSTA 1985, s 154 of the Child Support Act 1991, and s 46 of the Student Loan Scheme Act 1992;
(b) A liable person in relation to child support;
(c) A student loan borrower with a repayment obligation; and
(d) An employer in relation to compulsory employer contributions required under the KiwiSaver scheme [TAA, s 120B].

A taxpayer may not object to or challenge the imposition of UOMI payable. However, this does not limit a taxpayer’s right to object to or challenge their liability to pay tax [TAA, s 120I]: see TRA Case U36 (2000) 19 NZTC 9,347.

“CIR’s paying rate” means the rate of interest established and notified as the CIR’s paying rate by an Order in Council [TAA, ss 120C, 120H]. The CIR’s paying rate is set at the Reserve Bank of New Zealand’s 90-day bank bill rate series less 100 basis points (one per cent). See 1110.295 for the rates.

“Date interest starts”:
(a) For unpaid tax means:
   (i) If a taxpayer pays too little tax by a due date:
       (A) The day after the due date for payment of the tax; or
       (B) Where the due date is a new due date or, in the case of GST, a later due date for payment of the tax, the day after the original due date for payment of the tax;
   (ii) If the CIR refunds or applies tax which should be kept and taken into account in respect of satisfying a taxpayer’s tax liability at a due date, the day after the day the CIR refunds or applies the tax; and
   (iii) For a provisional taxpayer to whom s 120KE(7) of the TAA applies, the day after whichever dates of instalments B, D, and F for their corresponding income year occur 30 days after their last ratio instalment date;
(b) For overpaid tax, other than GST or FBT for the final quarter of a tax year, means the later of the following days:
   (i) If a taxpayer pays too much tax by or after a due date and subparagraph (iv) does not apply:
       (A) The day after the later of the due date for payment of the tax and the date the payment is made; or
       (B) Where the due date is a new due date, the day after the later of the original due date for payment of the tax and the day on which the payment is made;
   (ii) If a tax return is also to be provided in respect of the tax, the day after the tax return is provided;
   (iii) For a taxpayer to whom s 80D of the TAA applies, the date on which the initial income statement [see 1270.75] is issued;
   (iv) For a provisional taxpayer other than one to whom s 120KE(1) or (3) of the TAA applies, the first day of the income year; and
   (v) For a provisional taxpayer to whom s 120KE(6) of the TAA applies, the later of:
       (A) The day after the date set out in s RC 18(3);
       (B) The day after their last ratio instalment date;
(c) For a GST refund, means the latest of the following days:
   (i) The day after the earlier of:
       (A) The 15th working day after the taxpayer provides a tax return for the return period to which the GST refund relates; and
(B) The original due date for payment of output GST in respect of that return period;

(ii) The day after the day on which the tax return is provided; and

(iii) The day after the date on which the payment is made;

(d) For overpaid tax, being FBT for the final quarter of a tax year, means the later of 31 May next following the end of the final quarter and the date on which the return for the final quarter is filed;

(e) For tax paid, being a deposit to a tax pooling account in accordance with ss RP 17 to RP 21, means the date on which the deposit is made, unless the CIR refunds the deposit as required by s RP 18(5), in which case there is not a date on which interest starts; and

(f) For unpaid tax, being terminal tax for the tax year in which a taxpayer dies, the due date for the deceased person’s terminal tax, if:

(i) Each instalment of provisional tax payable by the deceased person for that tax year is paid by the due date under s RC 6 for the instalment; and

(ii) The terminal tax payable by the deceased person for that tax year is paid by the due date under s RA 13 for the terminal tax.

“Interest paid to a taxpayer” means interest credited to, or dealt with in the interests of or on behalf of, the taxpayer; and “interest paid” and “paid” have corresponding meanings.

“Interest period” means:

(a) For unpaid tax, the period beginning on the date interest starts and ending on the date the tax is paid or credited as paid (both dates inclusive);

(b) For overpaid tax, the period (both dates inclusive) beginning on the date interest starts and ending on the earlier of:

(i) The date the tax is refunded by the CIR; and

(ii) The date the tax is applied by the CIR towards meeting another tax liability.

“Tax paid”, at a time, means:

(a) An amount of tax that -

(i) Is paid or credited by the time for a tax liability; and

(ii) Has not been refunded or applied by the CIR to satisfy another tax liability;

(b) An amount credited by the time to a tax pooling account;

(c) An amount credited or transferred by the time to a taxpayer’s account with the CIR from a tax pooling account.

“Tax payable”, at any time, means the amount of tax payable in respect of a tax liability by that time, determined in accordance with the tax laws, and includes an amount of tax that must be withheld or deducted under a tax law and paid to the CIR.

“Taxpayer’s paying rate” means the rate of interest established and notified as the taxpayer’s paying rate by an Order in Council. The taxpayer’s paying rate is set at the floating first mortgage new customer housing rate series, plus 250 basis points (2.5 per cent). See 1110.295 for the rates.

Where at any time:

(a) The tax paid by a taxpayer exceeds the tax payable, the excess is “overpaid tax”; and

(b) The tax payable by a taxpayer exceeds the tax paid, the excess is “unpaid tax” [TAA, s 120C].

The Governor-General may, from time to time, by Order in Council:

(a) Specify the criteria and other requirements by and against which interest rates will be set or reset and notified; and

(b) Set the CIR’s paying rate and taxpayer’s paying rate [TAA, s 120H].
Interest continues to accrue on deferrable tax even though a taxpayer has or may have no liability at the time to pay the deferrable tax. [TAA, s 120T].

If, under a tax law, a taxpayer provides the CIR with a bond or other security so that the taxpayer is not required to withhold or deduct tax from a payment and the CIR subsequently determines that the payment was liable to a have an amount of tax withheld or deducted, the due date for the purpose of the definition of “date interest starts” for withholding or deducting the amount of tax is the date on which the amount withheld or deducted would have been payable to the CIR if a bond or other security had not been provided [TAA, s 120U].

1110.295 Liability to pay interest [TAA, ss 120D, 120E, 120W, 183F]

Taxpayers are liable to pay interest on unpaid tax. The CIR can recover interest payable on unpaid tax as though it were tax (of the same type as the unpaid tax) payable by the taxpayer and the CIR must pay interest on overpaid tax to a taxpayer. If the CIR pays too much interest to a taxpayer, the CIR can recover the excess in the same manner as income tax that is payable [TAA, s 120D].

A taxpayer is not liable to pay interest if the amount of income tax or ancillary tax outstanding is $100 or less. Similarly, the CIR is not liable to pay interest to the taxpayer if the amount of overpaid tax is $100 or less [TAA, s 183F].

A taxpayer is not liable to pay interest on unpaid tax to the extent to which the interest arises because the taxpayer relied on a CIR’s official opinion (given on or after 7 September 2010). A “Commissioner’s official opinion” means:

(a) An opinion of the CIR concerning the tax affairs of the taxpayer given (either orally or in writing) after all relevant information has been provided to the CIR, if that information is correct;

(b) A finalised official statement of the CIR, in writing, if it specifically applies to the taxpayer’s situation. Private binding rulings are not official opinions [TAA, s 120W].

The amount of interest payable by a taxpayer on unpaid tax or by the CIR on overpaid tax is calculated for each day in the interest period in accordance with the following formula:

\[
\frac{(t \times r)}{365}
\]

Where:

\( t \) is the unpaid tax or overpaid tax on which the interest is payable; and

\( r \) is the CIR’s paying rate or the taxpayer’s paying rate applying on the day (see below).

The amount of interest payable in an interest period, is the sum of the amounts calculated using the formula for each day in the interest period.

The amount of interest outstanding at any time in an interest period is the sum of the amounts calculated using the formula for each day in the interest period that falls before that time less any interest that has been paid by that time [TAA, s 120E].

Except where a tax law provides otherwise, interest payable by a taxpayer to the CIR on unpaid tax is payable immediately and without the need for a demand [TAA, s 120G].

(1) Use of money interest rates (per cent)

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<thead>
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<th>Period</th>
<th>CIR’s paying rate (for overpayments)</th>
<th>Taxpayer’s paying rate (for underpayments)</th>
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<tbody>
<tr>
<td>Up to 6 July 1998</td>
<td>7.10%</td>
<td>13.90%</td>
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<tr>
<td>7 July 1998 - 7 November 1998</td>
<td>8.26%</td>
<td>14.69%</td>
</tr>
<tr>
<td>8 November 1998 - 7 March 1999</td>
<td>4.79%</td>
<td>12.48%</td>
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<td>8 March 1999 - 7 March 2000</td>
<td>3.38%</td>
<td>10.59%</td>
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<td>8 March 2000 - 7 November 2000</td>
<td>4.67%</td>
<td>10.84%</td>
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<tr>
<th>Period</th>
<th>CIR’s paying rate (for overpayments)</th>
<th>Taxpayer’s paying rate (for underpayments)</th>
</tr>
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<td>8 November 2000 - 7 November 2001</td>
<td>5.74%</td>
<td>12.62%</td>
</tr>
<tr>
<td>8 November 2001 - 7 March 2005</td>
<td>4.83%</td>
<td>11.93%</td>
</tr>
<tr>
<td>8 March 2005 - 7 March 2007</td>
<td>5.71%</td>
<td>13.08%</td>
</tr>
<tr>
<td>8 March 2007 - 28 February 2009</td>
<td>6.66%</td>
<td>14.24%</td>
</tr>
<tr>
<td>1 March 2009 - 28 June 2009</td>
<td>4.23%</td>
<td>9.73%</td>
</tr>
<tr>
<td>29 June 2009 - 15 January 2011</td>
<td>1.82%</td>
<td>8.91%</td>
</tr>
<tr>
<td>From 16 January 2011</td>
<td>2.18%</td>
<td>8.89%</td>
</tr>
</tbody>
</table>

**1110.300 Interest priority [TAA, s 120F]**

If a taxpayer has unpaid tax to pay, and is liable to pay interest on the unpaid tax, any payment the CIR receives or applies on account of the taxpayer’s liability for the return period must first be applied towards payment of the interest. The CIR may apply interest payable to a taxpayer towards the taxpayer’s payment of unpaid tax after the date the taxpayer furnishes their return of income, provided that the CIR is not prevented from doing so by a tax law.

If, for a period, a taxpayer is liable to pay the CIR interest on unpaid tax, and the CIR is liable to pay the taxpayer interest on overpaid tax, the CIR may assess the taxpayer for the net amount or pay the taxpayer the net amount, as applicable, for the period.

The expressions “unpaid tax” and “overpaid tax” include:

(a) Any tax which has not been paid or which has been overpaid; and

(b) Any civil penalty imposed in respect of that tax which has not been paid or which has been overpaid, as if the tax and the civil penalty were a single tax type.

**1110.305 Interest on provisional tax [TAA, ss 120KB-120O]**

**(1) Instalments and due dates [s 120KB]**

For the purposes of the UOMI rules, a provisional taxpayer’s residual income tax (RIT) is due and payable under s RC 9. If a provisional taxpayer uses a GST ratio to determine the amount of provisional tax payable, and an adjustment to a base amount referred to in s RC 8 will, or is likely to, change the amount payable, the taxpayer may ask the CIR to make the adjustment and reassess their liability.

For the purposes of ss 120KB to 120KE of the TAA, RIT means a person’s RIT for a tax year as defined in s YA 1:

(a) As increased by an amount calculated in relation to the person and the income year under s MF 6(2); or

(b) As reduced by an amount calculated in relation to the person and the income year under s LA 4(1).

These rules do not apply to a transitional year or to a new provisional taxpayer.

**(2) RIT of new provisional taxpayers [TAA, s 120KC]**

In a tax year other than a transitional year, a new provisional taxpayer’s RIT is treated as due and payable:

(a) In three equal instalments on the interest instalment dates B, D, and F for the taxpayer’s corresponding income year, if s RC 9(9)(a) applies;

(b) In two equal instalments on the interest instalment dates, for the corresponding year:

(i) D and F, if provisional tax is payable in two instalments as per s RC 9(9)(b)(i); or

(ii) C and F, if provisional tax is payable in two instalments as per s RC 9(9)(b)(ii);
Penalties and Interest

(c) In one instalment on the interest instalment date F for the taxpayer’s corresponding income year, if provisional tax is payable in one instalment as per s RC 9(9)(c).

A reference to an instalment classified by the letters A to F is a reference to an instalment date in the table in sch 3, Part A on which an instalment of provisional tax is payable by a provisional taxpayer for an income year that corresponds to a tax year.

(3) Provisional tax instalments in transitional years [TAA, s 120KD]

For a transitional year to which sch 3, part B applies, the RIT of a provisional taxpayer, other than a person to whom s 120KE(1) or (3) of the TAA applies, is due and payable as determined under ss RC 21 to RC 24.

A provisional taxpayer in a transitional year is liable for UOMI for unpaid tax in relation to the instalments of provisional tax payable in the months set out in sch 3, Part B. The date interest starts is the day after the day on which payment of the instalment is due under s RC 21.

For the purposes of calculating the amount of interest due in relation to an instalment of provisional tax other than a final instalment, the amount of RIT payable on the instalment date is calculated using the formula:

\[
\text{Interest} = \frac{(\text{Residual Income Tax} \times \text{Instalment Period})}{\text{Months in Transitional Year}}
\]

Where:

“Instalment period” is either:

(a) Four, for provisional taxpayers who pay on the equivalent of instalment dates B, D, and F; or

(b) Six, for provisional taxpayers who pay on the equivalent of instalment dates C and F.

For the purposes of calculating the amount of interest due in relation to a final instalment of provisional tax, the amount of RIT payable is the RIT for the tax year minus any amount treated as due on an instalment date.

A provisional taxpayer includes a new provisional taxpayer.

(4) Provisional tax and rules on UOMI [TAA, s 120KE]

A provisional taxpayer’s RIT for a tax year is due and payable in one instalment on their terminal tax date if:

(a) They are a natural person, other than in their capacity as trustee;

(b) Their RIT is less than $50,000 for the tax year;

(c) They have not estimated their residual income tax for the tax year;

(d) They have not used a GST ratio in the tax year to determine the amount of provisional tax payable for the tax year; and

(e) They have not at any time in the tax year held an RWT exemption certificate.

When the above conditions are met, the provisional taxpayer:

(a) Is not liable for UOMI under s 120D of the TAA for unpaid tax until their terminal tax date; or

(b) Is not entitled to UOMI under s 120D of the TAA for overpaid tax until their terminal tax date.

A provisional taxpayer’s RIT for a tax year is due and payable in one instalment on their terminal tax date if:

(a) They use a GST ratio to determine the amount of provisional tax payable for the tax year; and

(b) They use the GST ratio as the determination method for the whole of the corresponding income year.

When these conditions are met, in relation to the amount of provisional tax paid or payable for the period in the corresponding income year in which the GST ratio is used, the provisional taxpayer:

(a) Is not liable for UOMI under s 120D of the TAA for unpaid tax until their terminal tax date; or

(b) Is not entitled to UOMI under s 120D of the TAA for overpaid tax until their terminal tax date.

If, under s RC 18, a provisional taxpayer changes the way they determine the amount of provisional tax, the taxpayer is not entitled to UOMI for overpaid tax under s 120D of the TAA until the later of:
Penalties and Interest

1110.305(5)

(a) The day after the date:
   (i) On which they notify the CIR under s RC 18(2); or
   (ii) Set out in s RC 18(3) (as the case may be);
(b) The day after their last ratio instalment date.

For debit interest, the taxpayer is liable for UOMI:

(a) For the period of the tax year in which they use the GST ratio, from the later of the dates set out above; or
(b) For the period of the tax year in which they estimate their provisional tax, from whichever dates of instalments B, D, and F for their corresponding income year occur 30 days after their last ratio instalment date.

A reference to an instalment classified by the letters A to F is a reference to a date in the table in sch 3, Part A, on which an instalment of provisional tax is payable by a provisional taxpayer for an income year that corresponds to a tax year.

(5) Meaning of unpaid tax and overpaid tax [TAA, s 120L]

For the purposes of determining amounts of unpaid tax and overpaid tax in respect of instalment dates for a tax year, a taxpayer’s RIT is calculated in accordance with the definition of that term in s 120KB(4) (see above). If a taxpayer makes a payment and does not specify how the payment is to be applied, the CIR must apply the payment towards the provisional tax that is due on an instalment date to which the CIR considers the payment relates. If the taxpayer makes a payment and specifies that it is made to meet their provisional tax due on an instalment date, the CIR must apply the payment towards the provisional tax specified by the taxpayer.

(6) Where provisional tax paid by a company does not count as overpaid tax [TAA, s 120M]

No amount of tax paid by a company is to be treated as overpaid tax to the extent that:

(a) The tax is provisional tax paid by the company for a tax year in excess of the company’s RIT for the tax year, and is retained by the CIR under ss RM 13 to RM 17, RM 32 and RZ 6 at any time after the company would, but for those sections, be entitled to a refund of the tax; or
(b) The tax would not be in excess of the company’s RIT for a tax year, but for the payment of an instalment of provisional tax being satisfied by an amount of further income tax in accordance with s RC 35.

(7) Variation to definition of date interest starts [TAA, ss 120N, 120O]

Where the due date for the payment of tax is an instalment date for provisional tax, the definition of “date interest starts” is to be construed as if the words “the later of the following days” and subparagraph (ii) were omitted from paragraph (b) of that definition.

The definition of “date interest starts” is to be construed as if the words “the later of the following days” and subparagraph (ii) were omitted from paragraph (b) of that definition when:

(a) A payment required by ss RA 5 and RD 4 is due to be paid to the CIR no later than 5 April in a year;
(b) A payment required by ss RA 5 and RD 23(3) is due to be paid to the CIR no later than 20 April in a year;
(c) A payment required by ss RA 6, RE 20 and RE 21 is due to be paid to the CIR no later than 20 April in a year;
(d) A payment required by ss RA 6 and RF 13 is due to be paid to the CIR no later than 20 April in a year.
1110.310  Spreading tax liability or apportioning income back over earlier tax years [TAA, s 120P]

If, under a tax law:

(a) A taxpayer elects to spread a tax liability over the tax year for which the election is made (election tax year) and one or more earlier tax years; or

(b) The CIR allocates income from a tax year (allocation tax year) to one or more earlier tax years, to the extent the election or allocation alters the taxpayer’s income tax liability for a tax year that precedes the election tax year or allocation tax year, as the case may be (the extent of that alteration being called “affected tax”), the taxpayer is not required to pay UOMI on the affected tax before the taxpayer’s terminal tax date for the election tax year or allocation tax year.

If income of a taxpayer is allocated to a tax year, the taxpayer shall allocate to the tax year that proportion of deductions allowed in the allocation tax year which the allocated income represents as a proportion of the income for the allocation tax year calculated without allocation.

1110.320  Interest and PAYE intermediaries [TAA, ss 120OB, 120OC]

The following definitions apply for the purpose of determining the interest chargeable or payable to a PAYE intermediary [see 1080.80], if the employer has:

(a) Paid to the intermediary the salary or wages as required by ss RP 9 to RP 11; and

(b) Provided to the intermediary the information requested by the intermediary as required by s RP 8(b).

“CIR’s paying rate” means the rate of interest established and notified as the CIR’s paying rate by an Order in Council made under s 120H of the TAA.

“Date interest starts”:

(a) For unpaid tax means:

(i) If a PAYE intermediary pays too little tax by due date:

(A) The day after the due date for payment of the tax; or

(B) Where the due date is a new due date, the day after the original due date for payment of the tax;

(ii) If the CIR refunds tax which should be kept and taken into account in satisfying tax payable by a PAYE intermediary on a due date, the day after the day the CIR refunds the tax; and

(b) For overpaid tax, if a PAYE intermediary pays too much tax by or after a due date, means:

(i) The day after the later of the due date for payment of the tax and the date the payment is made; or

(ii) Where the due date is a new due date, the day after the later of the original due date for payment of the tax and the date on which the payment is made.

“Interest paid to a taxpayer” means interest credited to the PAYE intermediary; and “interest paid” and “paid” have corresponding meanings.

“Interest period”:

(a) For unpaid tax, means the period beginning on the date interest starts and ending on the date the tax is paid or credited as paid (both dates inclusive);

(b) For overpaid tax, means the period beginning on the date interest starts and ending on the date the tax is refunded by the CIR (both dates inclusive).

“Tax paid”, at any time, means the amount of tax that at that time:

(a) Has been paid or credited as paid in respect of a deduction of tax that must be made under a tax law; and
Penalties and Interest

(b) Has not been refunded by the CIR.

“Tax payable”, at any time, means the amount of tax that at the time is due to be withheld or deducted under a tax law and paid to the CIR.

“Taxpayer’s paying rate” means the rate of interest established and notified as the taxpayer’s paying rate by an Order in Council made under s 120H of the TAA.

The use of money interest rules in ss 120A, 120AA and 120D to 120I of the TAA apply to a PAYE intermediary as if references to a “taxpayer” were read as references to a “PAYE intermediary”. Sections 120EA, 120F(2) and 120F(3) of the TAA do not apply to a PAYE intermediary.

1110.325 Interest and intermediaries who operate tax pooling accounts

[TAA, s 120OD]

The use of money interest rules in ss 120A, 120AA and 120C to 120I apply to an intermediary who operates a tax pooling account [see 1150.77] in their capacity as an intermediary as if references to a “taxpayer” were read as references to an “intermediary”. Sections 120EA, 120F(2) and 120F(3) of the TAA do not apply to an intermediary.

1110.330 Assessability and deductibility of UOMI [ss CC 8, DB 3BEF 4, EF 5]

(1) Interest paid by the CIR

Interest payable by the CIR under Part 7 of the TAA (UOMI) is income of the person receiving it. UOMI is not subject to the financial arrangements rules, but is allocated to income years under s EF 4 [s CC 8]. Income that is UOMI paid by the CIR is allocated to the income year in which it is paid [s EF 4].

Before the 2011-12 income year, UOMI was allocated to a different income year in the following situations:

(a) If the CIR paid the interest in the same tax year as that to which the original assessment relates, the interest is allocated to the following income year;

(b) If the CIR amended the person’s assessment, the interest payable by the CIR as a result of the amended assessment is allocated to the income year following the income year in which the notice of amended assessment was issued. For this purpose, if the CIR amended the person’s assessment more than once in a tax year, only the last amended assessment is taken into account.

(2) Interest paid to the CIR

UOMI is deductible [s DB 3B]. Section DB 3B supplements the general permission and overrides the capital, private and employment limitations, although the other general limitations still apply. This means that a person paying UOMI does not have to satisfy the general permission in order to claim a deduction. A deduction for UOMI paid to the CIR is allocated to the income year in which the interest is paid [s EF 5].

Amendments clarifying the deductibility of UOMI, enacted in 2011, apply retrospectively from the 1997-98 income year (the start of the UOMI rules) for taxpayers who have claimed deductions for UOMI in returns filed or NOPAs issued before 24 November 2010. The amendments also apply generally to the 2010-11 and later income years. See TIB vol 23:8 (October 2011), at 56.

Before the 2011-12 income year, a deduction for UOMI paid to the CIR was allocated to the income year in which the person’s original assessment was made, except in the following situations:

(a) If the original assessment was made in the same tax year as that to which the income tax liability relates, the deduction is allocated to the following income year;

(b) If the CIR amends the person’s assessment, a deduction for interest payable to the CIR as a result of the amended assessment is allocated to the income year following the income year in which the CIR issues the notice of amended assessment (except in those circumstances listed in item (c));

(c) If the CIR amended the person’s assessment, a deduction for interest payable to the CIR as a result of the amended assessment is allocated to the income year in which the CIR issued the notice of amended assessment, in the following circumstances:
(i) The person dies, goes into liquidation, or otherwise ceases to exist before the income year following that in which the CIR issues the notice of amended assessment; and
(ii) The person would have been allowed a deduction for the interest payable if it had been incurred in the income year in which the notice of amended assessment was issued; and
(iii) The person’s executor or other representative asks the CIR.

For the purpose of item (c), if the CIR amended the person’s assessment more than once in a tax year, only the last amended assessment is taken into account.

The pre-2011-12 allocation rules outlined above, apply even though the income tax liability giving rise to the obligation to pay interest, and the period for the interest payment, may have fallen wholly or partly in a different tax year from that in which the obligation to pay interest arose.

1110.335 Remission of penalties for reasonable cause [TAA, s 183A]

The CIR may remit the penalties listed below if the CIR is satisfied that:

(a) The penalty arose as a result of an event or circumstance beyond the control of the taxpayer (for example, an accident or disaster, illness, or emotional or mental distress); and
(b) As a consequence of the event or disaster the taxpayer has a reasonable justification or excuse for the failure to comply; and
(c) The taxpayer corrected the failure to comply as soon as practicable.

The penalties which may be remitted are:

(a) Late filing penalty;
(b) Non-electronic filing penalty;
(c) Late payment penalty;
(d) Imputation penalty tax imposed by s 140B of the TAA;
(e) Maori authority distribution penalty tax imposed by s 140CB of the TAA;
(f) Shortfall penalty imposed by s 141AA of the TAA for failing to deduct tax from a schedular payment to a non-resident contractor;
(g) A civil penalty imposed under ss 215 or 216 of the KiwiSaver Act 2006 for failing to provide information or make deductions;
(h) A penalty under s 141ED of the TAA for not paying employer monthly schedule amount (from 1 April 2008).

An event or circumstance does not include:

(a) An act or omission of an agent of a taxpayer, unless the CIR 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.

The CIR’s policy (standard practice statement) on the remission of penalties under s 183A of the TAA is set out in TIB vol 14:12 (December 2002) at 52-54.

The main points of the policy are as follows. The policy applies to remission requests received from 4 December 2002. The request for remission must be in writing and the taxpayer may be required to produce relevant information. There is no right to dispute the CIR’s decision. Remission will only occur if the taxpayer is able to provide reasonable justification for the late filing, non-electronic filing, or late payment. The term “reasonable” must be applied to the event or circumstance. It is an objective test which requires that it be reasonable for a person in the taxpayer’s position not to have complied. In deciding whether remission is appropriate the CIR will consider:
Penalties and Interest

(a) Has the penalty been correctly charged?
(b) Has the taxpayer paid the tax (or filed the return) in question?
(c) Why did the taxpayer pay (or file) late, or not file electronically?
(d) Was the non-compliance caused by an event or circumstance that was:
   (i) An accident or a disaster?
   (ii) Illness or emotional or mental distress?
(e) Has this reason been used before? Where appropriate, have measures been put in place by the taxpayer to ensure that this situation does not recur in the future?
(f) Was the tax paid or return filed as soon as “practicable” (as soon as it can be done, and as soon as is feasible and realistic)? This will depend on each case, specifically was the default corrected as soon as possible after the event or circumstance passed?
(g) Was the non-compliance an act or omission of the taxpayer’s agent? Did an event or circumstance beyond the control of the agent cause it? Could the default have been avoided by compliance with accepted standards of business organisation and professional conduct?
(h) Any other information that the CIR considers relevant in assessing the application.

For examples see TES 2 (March 2003) 28.

1110.340 Cancellation of interest [TAA, s 183C]

A taxpayer’s liability to pay interest under Part 7 of the TAA will be cancelled for the period from the date of the notice of assessment until the due date specified in the notice, if the tax assessed in the notice is paid to the CIR by the due date for payment specified in the notice.

Where the CIR issues a notice of assessment to a taxpayer before the original due date for payment of the tax to which the assessment relates and the tax assessed in the notice is paid to the CIR on or before the 30th day after the date on which the notice of assessment is issued, the CIR must cancel the taxpayer’s liability to pay interest for the period from the day after the date on which the notice of assessment is issued to the day on which payment is made.

Where the CIR issues a statement of account to a taxpayer after the original due date for payment of tax to which the statement relates, and the tax referred to in the statement together with any UOMI for the period before the date of the statement is paid on or before the 30th day after the statement date or the due date of the tax (whichever is earlier), the CIR will cancel the liability to interest for the period from the day after the statement was issued until the day the payment was made.

If the CIR issues both a notice of assessment and a statement of account to a taxpayer, and the 30th day referred to in the third paragraph occurs on or before the 15th day referred to in the fourth paragraph, the CIR must cancel the taxpayer’s liability to pay interest for the period from the day after the date on which the notice of assessment is issued to the date on which payment is made, if payment (the tax assessed in the notice of assessment plus any interest for the period before the date of the notice) is made on or before the 30th day referred to in the third paragraph.

The CIR may remit UOMI if the taxpayer is significantly affected by the February 2004 flooding, or a similar future event, and the CIR considers that it would be equitable to remit the interest. No time limit is set for the remission to apply, although the taxpayer must apply for the remission as soon as practicable [TAA, s 183ABA].

1110.342 Emergency event interest remission [TAA, s 183ABA]

A taxpayer may ask the CIR to remit UOMI if:
(a) An emergency event physically prevents the taxpayer from making a tax payment on or before the due date;
(b) The taxpayer is charged with UOMI for failing to make the payment by the due date; and
(c) The taxpayer is a member of a class of persons to whom remission is available.
Penalties and Interest

The CIR may remit the UOMI if satisfied that it is equitable to do so, and the taxpayer made the payment and sought relief as soon as practicable.

An event may be declared an emergency event by Order in Council if the event:

(a) Is the result of any happening, whether natural or otherwise, including, without limitation, any explosion, earthquake, eruption, tsunami, land movement, flood, storm, tornado, cyclone, serious fire, leakage or spillage of any dangerous gas or substance, technological failure, infestation, plague, epidemic, failure of or disruption to an emergency service or a lifeline utility, or actual or imminent attack or warlike act; and

(b) Causes or may cause loss of life or injury or illness or distress, or in any way endangers the safety of the public or property in New Zealand or any part of New Zealand [parts (a) and (b) of definition of “emergency” in s 4 of the Civil Defence Emergency Management Act 2002].

A class or classes of person to whom a remission is available in relation to an emergency event may be described by Order in Council.

(1) Canterbury earthquakes

The Tax Administration (Emergency Event–Canterbury Earthquake) Order 2010 declared the Canterbury earthquake that occurred on 4 September 2010, and all of its aftershocks, to be an emergency event for the purposes of s 183ABA of the TAA. Taxpayers that are physically prevented by the earthquake or any of its aftershocks from making a payment required by tax law may ask the CIR to remit interest charged under Part 7 of the TAA for failing to make payments on due date. This will apply, for example, to individuals and companies that are prevented from making PAYE payments to the CIR because staff or tax agents are unable to access a building where the records are kept, or because the records have been destroyed.

The CIR may remit interest if satisfied that:

• It is equitable that the interest be remitted;
• The taxpayer asked for the relief as soon as practicable; and
• The taxpayer made the payment as soon as practicable.

The order was originally due to expire on 31 March 2011, but has since been extended to 30 September 2012 by amendment orders.

1110.343 Cancellation of interest charged to non-residents working in Canterbury earthquake recovery programme [TAA, s 183CB]

When non-resident workers stay in New Zealand for more than a given period, PAYE withholding and provisional tax obligations are backdated to the first day of presence in New Zealand. The backdating often means that payments of tax are overdue, and interest is imposed on the overdue tax. This is inappropriate in the case of non-residents who are assisting in the Canterbury earthquake recovery programme. Accordingly, s 183CB requires the CIR to cancel the liability to pay the interest.

Cancellation of interest applies to a person (the earner) who derives income in the form of payment for work in the programme for the recovery of Canterbury from the Canterbury earthquakes (as defined in the Canterbury Earthquake Recovery Act 2011), when:

(a) The income relates to the period beginning after 4 September 2010 and ending before 4 September 2011; and

(b) The earner is a non-resident, or is treated as a non-resident under a relevant double tax agreement, on 4 September 2010 and:

(i) Is a natural person who arrives in New Zealand after that date; or

(ii) Is not a natural person and, under the double tax agreement, has no permanent establishment in New Zealand on 4 September 2010 but after that date has a permanent establishment in New Zealand or is a resident and not treated as a non-resident.

Cancellation applies to both:
Penalties and Interest

(a) Interest on overdue tax withheld from PAYE income payments; and
(b) Interest on overdue provisional tax instalments.

In both cases, the earner must apply for the interest to be cancelled.

1110.345 Other issues relating to remission and cancellation of tax [TAA, ss 183D, 183E, 183G, 183H, 183I]

The CIR may remit the penalties listed below if the CIR is satisfied that the remission is consistent with the CIR’s duty to collect over time the highest net revenue that is practicable within the law. The penalties that may be remitted are:

(a) Late filing penalty;
(b) Non-electronic filing penalty;
(c) Late payment penalty;
(d) Shortfall penalty under s 141AA of the TAA for failing to deduct tax from a withholding payment to a non-resident contractor;
(e) A civil penalty imposed under ss 215 or 216 of the KiwiSaver Act 2006 for failing to provide information or make deductions;
(f) A penalty under s 141ED of the TAA for not paying employer monthly schedule amount (from 1 April 2008); and
(g) UOMI.

The CIR must also have regard to the importance of the penalty and interest in promoting compliance, especially voluntary compliance, by all taxpayers and other persons with the Inland Revenue Acts. The CIR cannot consider a taxpayer’s financial position when considering whether to remit a penalty under s 183D of the TAA.

The CIR’s practice in respect to granting remission of penalties and interest under ss 183A, 183ABA and 183D of the TAA is set out in standard practice statement SPS 05/10 [see TIB vol 17:9 (November 2005) at 68-74]. SPS 05/10 applies to remission requests received by Inland Revenue from 17 October 2005. The standard does not apply to shortfall penalties, child support penalties and interest, or student loan repayments. The main points of the statement are as follows:

(a) Applications for remission under ss 183A and 183D of the TAA should be made in writing and should be accompanied by supporting information. The requirement to apply in writing contradicts s 183H(a) of the TAA, which was amended with effect from the 2005-2006 tax year to remove the requirement that notice must be in writing.

(b) The CIR will remit penalties under s 183A of the TAA where he is satisfied that the non-compliance has been caused by an event or circumstance that provides reasonable justification or excuse for the omission, and the omission was rectified as soon as practicable.

(c) The CIR will remit interest under s 183ABA of the TAA where:
   (i) A taxpayer is significantly affected by a “qualifying event”; and
   (ii) The taxpayer has applied for remission of interest as soon as practicable; and
   (iii) The CIR is satisfied that the effect on the taxpayer of the occurrence of the qualifying event makes the remission equitable.

(d) The CIR will remit penalties and/or interest under s 183D of the TAA if the CIR is satisfied that remission is consistent with the duty to collect over time the highest net revenue that is practicable within the law. Generally, the CIR will grant remission of penalties where there was a genuine oversight, a “one-off” situation, or incorrect advice was given by an Inland Revenue officer that led to the taxpayer not filing their return or paying the tax on time.

(e) The CIR will remit interest in limited circumstances such as where an Inland Revenue officer has given incorrect advice to the taxpayer, and that advice has directly resulted in the non-compliance.
However, this is not the only situation in which interest may be remitted. The CIR will consider each case on its own merits.

(f) Remission applications under ss 183A and 183D of the TAA will only be considered when the returns relevant to the remission requests have been filed and the tax has been paid.

(g) Sections 183A and 183D of the TAA do not permit remission to be granted for financial reasons. Requests for financial relief are dealt with under ss 176 and 177 of the TAA.

For examples see TES 2 (March 2003) 28.

The CIR has no discretion to remit shortfall penalties. Any interest payable in respect of tax that has been remitted by the CIR will also be remitted [s 183E of the TAA]. In TIB vol 11:8 (September 1999) at 29, the CIR indicated that he will also reverse interest when a retrospective change to legislation causes the position taken by a taxpayer to become incorrect after it was taken. In this situation, a new due date for payment would be made and the interest would be cancelled.

If interest or a civil penalty payable by a taxpayer is remitted by the CIR or a liability to pay the amount is cancelled, and the taxpayer has already paid the amount, the CIR will refund the amount to the taxpayer or apply the amount towards meeting another tax liability [TAA, s 183G].

To obtain the remission of interest or tax imposed under ss 183A or 183D, a taxpayer must apply to the CIR and produce such information as the CIR requires in relation to the request. The application for remission need not be in writing (eg the request could be made by phone, fax, or email) [TAA, s 183H]. However, a written application must be made for remission of the following:

(a) Imputation penalty tax;
(b) Maori authority distribution penalty tax;
(c) A shortfall penalty imposed on a non-resident contractor by s 141AA;
(d) UOMI.

Where a taxpayer’s tax liability or obligation is cancelled, the cancellation is deemed to take effect at the time the tax liability or obligation arose. A taxpayer is never liable to pay interest or a civil penalty in respect of a tax liability or obligation that is cancelled [TAA, s 183I].

**Compulsory remission of late payment penalties and interest**

[TAA, ss 181C, 181D, 183AA]

The CIR must remit UOMI and any late payment penalties, where a company is liable to pay further income tax under s OB 65 [see 670.95] and late payment penalties under s 139B of the TAA [see 1110.40], arising from unpaid income tax due in the same imputation year. The amount remitted must be equal to or less than the amount of unpaid income tax [s 181C of the TAA].

The CIR must remit UOMI and late payment penalties on the further income tax liabilities of Maori authorities when income tax liabilities are outstanding at the same time. The remission applies to the extent that the amount of the further income tax is equal to or less than the amount of unpaid income tax [TAA, s 181D].

The CIR must automatically remit a taxpayer’s late payment penalty and interest to the extent to which, objectively, the penalty is imposed because of errors in respect of the change in the GST rate on 1 October 2010 (for example, where the required systems changes to accommodate the new rate have not been able to be made in time) [TAA, s 183AA].

**Penalties and interest arising from unintended legislative changes**

Inland Revenue has issued two standard practice statements relating to the imposition of penalties and interest when a tax shortfall results from an unintended legislative change in the ITA 2004 or the ITA 2007. The standard practice statements are essentially identical.
Penalties and Interest

(1) **ITA 2004**

SPS 05/02 [see TIB vol 17:5 (June-July 2005) at 40-44] relates to the ITA 2004 and applies to the 2005-2006 to the 2007-2008 income years inclusive. The ITA 2004 rewrote Parts C to E of the ITA 1994, with no change in the law intended except as specifically identified in sch 22A of the ITA 2004. However, unintended legislative changes may arise as a result of the new wording used in the ITA 2004. Taxpayers who identify what they believe to be an unintended law change should notify the Rewrite Advisory Panel (Panel). The Panel may recommend that unintended law changes be corrected by amending legislation, and the Government may or may not pass such amending legislation.

The standard practice is that if a taxpayer incurs a tax shortfall as a result of an unintended legislative change in the ITA 2004, no shortfall penalty will be charged and the taxpayer will be entitled to apply in writing to the CIR for a remission of interest. The taxpayer will still need to have taken reasonable care and an acceptable tax position. To obtain a remission of the interest charged, a taxpayer will need to write to the CIR requesting remission, as this is a legislative requirement. The taxpayer will still be required to pay the shortfall of tax by the due date that is set for it.

(2) **ITA 2007**

SPS 08/03 [see TIB vol 20:10 (December 2008) at 35] relates to the ITA 2007 and applies from the 2008-2009 income year.

The ITA 2007 represents the final stage of a program to progressively rewrite the income tax legislation to make it clear and easy to understand. The ITA 2007 rewrites Parts F to Y of the ITA 2004 and makes consequential amendments to Parts A to E. The rewritten legislation is not intended to change the law except as specifically identified in sch 51 of the ITA 2007. However, unintended legislative changes may arise as a result of the new wording used in the ITA 2007. Taxpayers who identify what they believe to be an unintended law change can notify the Panel (as explained above).

If a taxpayer incurs a tax shortfall as a result of an unintended legislative change in the ITA 2007, no shortfall penalty will be charged and the taxpayer will be entitled to apply in writing to the CIR for a remission of interest. The taxpayer will still need to have taken reasonable care and an acceptable tax position. To obtain a remission of the interest charged, a taxpayer will need to write to the CIR requesting remission, as this is a legislative requirement. The taxpayer will still be required to pay the shortfall of tax by the due date that is set for it.

(3) **Examples**

The CIR identified two situations in which a shortfall incurred by a taxpayer is a result of an unintended legislative change. The two scenarios are set out below as they apply to the ITA 2007. However, they apply equally to the ITA 2004, simply by substituting “ITA 2004” for “ITA 2007”, “ITA 2004” for “ITA 1994” and “YA 3(4)” for “ZA 3(4)”.

**Scenario 1:**

In taking a tax position in their tax return, a taxpayer applies the ITA 2007, as the law is clear. An unintended legislative change from the ITA 2004 is later identified and confirmed by the Panel. On advice by the Panel, the Government amends the ITA 2007 retrospectively to be consistent with the ITA 2004. As a result of the amendment, a tax shortfall arises. It is established that the taxpayer has taken reasonable care and an acceptable tax position. In this situation, the taxpayer had taken an interpretation based on the words in the ITA 2007. The tax shortfall that subsequently arises is due solely to the unintended legislative change and the Government’s decision to amend the ITA 2007 retrospectively. In this instance no shortfall penalty will be imposed and the taxpayer will be entitled to a remission of interest upon written application to the CIR.

**Scenario 2:**

In taking a tax position in their tax return a taxpayer is required to have regard to the wording of the corresponding provisions of the ITA 2004, as the law in the ITA 2007 is unclear or leads to an absurd result. An unintended legislative change in the ITA 2007 is later identified and confirmed by the Panel. The Government decides not to amend the ITA 2007. As a result, a tax shortfall arises. It is established that the taxpayer has taken reasonable care and an acceptable tax position. In this situation the law in the ITA 2007 is not clear or leads to an absurdity. As required under s ZA 3(4) of the ITA 2007, the taxpayer has used the law in the ITA 2004 to interpret the meaning of the law in the ITA 2007. However, it is later established...
by the Panel that the meaning of the law in the ITA 2007 is different from that of the corresponding provision in the ITA 2004. The Government decides to retain the new meaning. Thus the tax shortfall that the taxpayer consequently incurs does not arise due to any fault of the taxpayer. No shortfall penalty will be imposed and the taxpayer will be entitled to a remission of interest upon written application to the CIR.

(4) Tax shortfall not due to an unintended legislative change

Outside the two scenarios above and the standard practice statements, a taxpayer’s liability to shortfall penalties and interest will be considered on a case by case basis according to normal principles. This will include the situations where an unintended legislative change is confirmed by the Panel but the tax shortfall incurred by the taxpayer did not arise due to the unintended legislative change. Rather, the tax shortfall arose as a result of an incorrect interpretation by the taxpayer.

There will also be instances where an unintended legislative change is not confirmed by the Panel. In this case, it will be clear that a tax shortfall incurred by the taxpayer did not arise due to an unintended legislative change but is the result of an incorrect interpretation by the taxpayer. These cases are no different to any other case when a tax shortfall arises. Whether a taxpayer incurs a shortfall penalty will be decided on the facts of each case, and whether the taxpayer took reasonable care and an acceptable tax position. Interest charged on the shortfall will be payable along with the outstanding tax. Generally, no remission of interest will be allowed. However, the taxpayer will still have the right to apply in writing to the CIR for a remission of interest and each case will be considered on its own merits in accordance with the relevant standard practice statement [see 1110.335 to 1110.345].

Scenarios 3 to 6 in the following table are outside the standard practice statement. Scenarios 3 and 4 are when there is a confirmed unintended legislative change but the tax shortfall that arises is not a result of the unintended legislative change. Scenarios 5 and 6 are when a potential unintended legislative change is not confirmed.

All six scenarios have been based on the assumption that the taxpayer has taken reasonable care and has an acceptable tax position when taking their tax position. In cases where a taxpayer has not taken reasonable care or has an unacceptable tax position, a shortfall penalty will be imposed.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Unintended change confirmed?</th>
<th>Unintended change reversed retrospectively?</th>
<th>Shortfall penalties?</th>
<th>Remission of interest?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Relies on new law</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>2. New law unclear and relies on old law</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>3. Relies on new law</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>4. New law unclear and relies on old law</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>5. Relies on new law</td>
<td>No</td>
<td>N/A</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>6. New law unclear and relies on old law</td>
<td>No</td>
<td>N/A</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

If a taxpayer has an overpayment due to any of the scenarios outlined in the table above the normal rules, as they pertain to the CIR paying the taxpayer interest, will apply.
Chapter 1120
Pensions and Annuities

1120.10 Pensions for past employment liable for PAYE [s RD 5]
An annuity, pension, or retiring allowance paid for the past services of the recipient (or of a person on whom the annuitant was dependent) comes within the definition of “salary or wages” for PAYE purposes, and PAYE tax should be deducted. Any payment deemed to be a pension under s CF 1(2) is similarly subject to the PAYE rules.

Where a pension for past employment is received from an overseas source, and NZ PAYE tax has not been deducted at source, the recipient becomes liable to account for the tax deductions that should have been made. This normally involves the pensioner personally making the calculation of the tax deduction and accounting for it to Inland Revenue using form IR56. Where the taxpayer has other provisional income, it may be more convenient to show the pension in the return as income not taxed at the time of receipt and to pay provisional tax accordingly.

1120.20 Pensions paid to former partners [s DC 3]
Pensions paid to a former business partner are deductible under certain circumstances. Deductibility of the payment requires the following:
(a) The business of the taxpayer or partnership making the payment is the same business as that carried on by the former partnership;
(b) The former partner has retired from the former partnership;
(c) The pension is granted under a deed and the former partner or former partner’s spouse [see 960.10] has a right to receive the pension for a fixed period or for life;
(d) The pension is paid for the former partner’s past services in the partnership; and
(e) The business of the taxpayer or partnership paying the pension does not exclusively or principally consist of the investment of money, or the holding of, or dealing in, shares, securities, investments, or land.

1120.30 Exempt pensions and annuities [ss CW 28, CW 30, CW 33, CW 34]
The following pensions and annuities are exempt:
(a) Pensions (s CW 28)
   (i) Certain war pensions or war allowances. However, where the amount is payable irrespective of whether the death is attributable to service in one of the specified forces (including police), ie it is in the nature of a normal service pension, it is not exempt;
   (ii) Portable New Zealand superannuation. Portable New Zealand superannuation is New Zealand superannuation that is payable to a person who is outside New Zealand for not more than 26 weeks. The 26-week threshold can be extended in certain circumstances;
(iii) Portable veterans’ pension;
(iv) Overseas pension payments are exempt to the extent to which they are subject to an arrangement under s 70(3) of the Social Security Act 1964. This includes various income tested benefits. However, the equivalent amount of New Zealand superannuation or veterans’ pension paid under s 70(3)(b) of the Social Security Act 1964 is not exempt [ss CW 28(2)(b), (2)].

(b) Annuities paid from the Crown bank account (s CW 30)
Annuities which are granted by the Executive Council of New Zealand, paid from the Crown bank account, and not designated as assessable are exempt from tax.

(c) Allowances and benefits (s CW 33)
(i) Monetary benefits payable under the Social Security Act 1964 including participation allowances. Income-tested benefits are not exempt;
(ii) Payments under the Accident Compensation Act 2001 or Part 5 of the Accident Insurance Act 1998 that are for treatment or rehabilitation, or are an independence allowance, funeral grant, survivor’s grant or childcare payment;
(iii) Disabled workshop payments. These are payments made to a disabled person for undertaking work in a sheltered workshop where the average amount paid in a tax year does not exceed $50 per week;
(iv) Amounts derived by, or distributed by, a trust set up for the benefit of thalidomide victims;
(v) Amounts derived by, or distributed by, the New Zealand Agent Orange Trust.

(d) Compensation payments (s CW 34)
(i) Certain payments relating to incapacity to work paid by a friendly society or a sickness, accident or death benefit fund, or under a policy of insurance where the amount is not calculated by reference to income or profits;
(ii) Payments made under the Workers Compensation Act 1956 or the Criminal Injuries Compensation Act 1963;
(iii) Ministerially approved distributions to ex-prisoners of war held in German concentration camps during the Second World War, and payments made by the Federal Republic of Germany or Austria to victims of National Socialist persecution;
(iv) Payments under sch 1 of the Crown Forests Assets Act 1989 (other than cl 3(b));
(v) Certain payments under the Maori Reserved Land amendment Act relating to compensation, solatium payments or the purchase of leases, but excluding interest under s 23 of that Act.

1120.40 General features of the taxation of annuities [ss CC 5, CW 4]
An annuity contract providing a life income which ceases immediately on the death of the person upon whose life it is granted, is income.
An annuity contract giving a life income and a further provision to repay the purchase money after deducting any annuity payments already made is assessable, but the return of the purchase price is not assessable.
An annuity contract giving a life income and a further provision that the annuity continues until the amount paid out equals the purchase money notwithstanding the prior death of the annuitant, is income. Where the purchase money is repaid during the lifetime of the annuitant, further payments received during the remainder of the life are similarly income.
Any annuity paid under a life insurance policy is exempt where the policy was offered or entered into by a life insurer either:
(a) In New Zealand; or
(b) Outside New Zealand where the life insurer is resident in New Zealand.
Pensions and Annuities

1120.50

“Annuity certain” means an annuity payable under a contract providing for a fixed number of payments, irrespective of the death of the annuitant before the final payment is made, the payments being calculated so as to return to the annuitant the amounts paid as premiums plus compound interest. The basic distinction between an annuity certain and a life annuity is that, in the latter case, the sum of the payments which fall to be made may prove to be less or greater than the sum paid by the annuitant, while in the former case it is the same amount as the annuitant paid with the addition of interest. Where the annuity has been purchased by the taxpayer personally, only that portion of the instalment of an annuity certain which represents interest is assessable. Where the annuity has been purchased by some other person, eg an employer or a relative, the whole of each payment received is taxable.

“Deferred annuity” means an annuity purchased by instalments in advance, the payments for which are made in a manner similar to life insurance premiums. A deferred annuity is assessable.

Where an annuity is sold, any income due but unpaid as at the date of sale is apportioned between the purchaser and the vendor.

1120.50 Annuities arising from debt satisfaction or consideration for business purchase

Where a life annuity is arranged in satisfaction of a debt owing, no deduction is allowed to the debtor (payer) for payments made on the annuity. The amount received is assessable to the payee.

Where an annuity is arranged in consideration for the purchase of a business, no deduction is allowed to the purchaser. The annuitant is assessable on the annuity received: T v Commissioner of Taxes (1943) 3 MCD 101.

There is a distinction between an annuity and the payment of a capital debt by instalments. If there is a debt owing and it is agreed that it shall be payable by annual instalments, the instalments are not annuities but capital receipts. The financial arrangement provisions may then apply.

1120.60 Pensions and annuities from foreign countries [s LJ 2]

Pensions, other than war pensions derived from foreign government and private sources, are generally assessable when derived by New Zealand residents. An exemption may apply under either general tax law or a double tax agreement. Any foreign tax, which has been deducted from any foreign pension which is assessable in New Zealand, may be allowed as a credit against the tax payable in New Zealand [s LJ 2].

Where a double tax agreement exists between New Zealand and the country from which the pension is derived, it may provide that the pension is assessed only in New Zealand, only in the country of source or, in some cases, in both countries. The applicable agreement should be consulted in each case as the provisions differ from country to country.

WINZ has taken responsibility for paying the British pension, derived from the UK Department of Health and Social Security. The pensions are no longer paid direct from the UK but are included with New Zealand superannuation payments. The regular payments of New Zealand superannuation include the British pension payments. In effect, British pensions to persons living in New Zealand are increased by a partial New Zealand superannuation supplement, so that the person receives same gross amount as would be the case if he or she was entitled only to New Zealand superannuation.

In Public Ruling BR Pub 07/10, the CIR has advised that Netherlands social security pensions are taxable only in New Zealand when received by a New Zealand tax resident who is also a New Zealand citizen. Where the recipient is a New Zealand tax resident but not a New Zealand citizen, the pension may be taxable both in New Zealand and in the Netherlands. In this case, the pension should be included in the person’s New Zealand tax return. The tax payable in New Zealand will be reduced by way of a credit for Netherlands tax paid on the pension [see TIB vol 20:1 (February 2008) at 3].

A purchased annuity derived from overseas by a New Zealand resident is liable to New Zealand income tax. However, under some double tax agreements, it may be exempt from tax in the country of origin. The rules applicable to pensions derived from foreign countries generally apply also to purchased annuities. Any
foreign tax that has been deducted from any foreign pension which is assessable in New Zealand may be allowed as a credit against the tax payable in New Zealand [s LJ 2].

1120.70 Testamentary annuities charged on property [s DX 1]

Annuities paid by a taxpayer are not usually an allowable deduction. However, property devised or bequeathed under a will may be charged with an annuity. Alternatively, the beneficiaries in a deceased estate may have decided to rearrange the provisions for distribution set down in a will through a deed of family arrangement. The distribution provisions might also have been rearranged through an order of the Court under the Family Protection Act 1955. In any of these cases, where any beneficiary is charged with a requirement to pay an annuity, a deduction may be allowed for all or some of the amount paid to the annuitant.

A “beneficiary”, in this context, means:

(a) A person to whom that property has been devised or bequeathed by will; or
(b) A person who is entitled under a will to purchase a property from the estate, subject to payment of an annuity; or
(c) A person who is entitled to the property under an order of the Court under the Family Protection Act 1955 or under a deed of family arrangement.

There are cases where, acting under a power in the will or under a subsequent court order or deed of family arrangement, the trustees transfer the assets to the remaindermen before the death of the life tenant or annuitant. Where this is done, the remaindermen frequently assume the liability for the annuity. In some cases, the annuity is met from a fund created by holding back in the estate sufficient assets to ensure an income which is adequate to provide the annuity.

When the remaindermen in an estate assume the liability for an annuity, it is usual for it to be secured in two ways. First, a mortgage is given over the estate assets which have been or are transferred to the legal ownership of the remaindermen. Secondly, the remaindermen each gives a personal covenant which is usually joint and several. Where the assets of an estate have been transferred to remaindermen subject to a liability, whether secured or not, to pay a testamentary annuity, the remaindermen may deduct the annuity as an expense incurred in deriving income. The rules are strictly construed. The essential elements are:

(a) There must be property (or substituted property which has subsequently replaced the original property, or a property substituted by the beneficiary to replace the substituted property) which was devised or bequeathed by will; and
(b) The property must be charged with an annuity either under the will, by a court order under the Family Protection Act 1955, or by a deed of family arrangement; and
(c) The property so charged must have been transferred to the beneficiaries entitled to receive it under the will, order, or deed on the condition that they assume liability for the annuity.

Where these conditions are all met, the beneficiary by whom the annuity is payable is allowed a deduction for any amount paid during the income year to the annuitant.

Example 1:

Property in an estate comprises a farm property which is leased to the remainderman (the only son and child of the deceased farmer) who pays rent to the estate trustees. The farmer’s widow is the life tenant in the estate and receives beneficiary income from the estate trustees, which is effectively the rent collected by the trustees from the remainderman less the expenses of the trustees. The widow and the son decide to terminate the life tenancy and remainderman provisions in the will, and to distribute the estate assets to the son. They enter into a deed of family arrangement whereby the farm property is transferred to the son, and the widow is assured of an income through the son undertaking to pay her an annuity. A charge is entered on the title to the property requiring the son to pay an annuity for a determinable amount to the widow during her lifetime. On the widow’s death, there is no further requirement to pay an annuity. In these circumstances, providing the provisions are strictly adhered to, the son is allowed a deduction for the annuity.

The deduction is limited to the income derived during the year by that beneficiary from the property on which the annuity is charged.
Example 2:
A farming property is charged with an annuity of $20,000 per annum and produced a net income of only $14,000. The deduction for the income year would be limited to $14,000. The annuitant would, of course, still be assessable on the $20,000 received.
Chapter 1130
Portfolio Investment Entities (PIEs)

1130.10 Background
The tax rules for portfolio investment entities (PIEs) came into force on 1 October 2007. The aim of the rules is to allow investors in collective investment vehicles (eg managed funds) to be taxed on their investment earnings in a manner similar to those who invest directly. Any gains on the sale of shares in New Zealand resident companies and certain Australian resident companies are excluded income in the hands of a PIE and therefore not subject to tax. A PIE that is also a multi-rate PIE is taxed at the marginal rate of the investors capped at 28 per cent.

Collective investment vehicles which do not qualify under the PIE rules are taxed on all of their earnings at the company rate of tax. They are also generally taxed on capital gains on the sale of shares as they are in the business of dealing in such investments.

The PIE regime is also integral to the introduction of the Kiwisaver regime [see 860 KIWISAVER].

1130.15 Portfolio investment entity types [s HM 2]
Portfolio investment entity (PIE) is the generic term to cover the five different types of PIE.

The five types of PIE are:
(a) Multi-rate PIEs (MRP);
(b) Listed PIEs (LP) [see 1130.45];
(c) Benefit fund PIEs (BFP) [see 1130.50];
(d) Life fund PIEs (LFP) [800.22]; and
(e) Foreign investment PIEs (FIP).

(1) Multi-rate PIEs
A multi-rate PIE can be a company, a superannuation fund, or a group investment fund. It must have first become a PIE [see 1130.20] and have not ceased to be a PIE [see 1130.30]. It cannot be a benefit fund PIE.

(2) Listed PIEs
A listed PIE is a company that:
Portfolio Investment Entities (PIEs) 1130.15(3)

(a) Is listed on a recognised exchange in New Zealand; or
(b) Meets the requirements of s HM 18 whereby an unlisted company that meets certain criteria can choose to become a portfolio listed company [see 1130.20].

It must have first have become a PIE [see 1130.20] and have not ceased to be a PIE [see 1130.30], or ceased to be a listed PIE. It must not have chosen to be a multi-rate PIE. It cannot be a life fund PIE.

(3) Benefit fund PIE

A benefit fund PIE is any defined benefit fund that does not allocate income to investors provided that it has first become a PIE [see 1130.20] and has not ceased to be a PIE [see 1130.30].

(4) Life fund PIE

A life fund PIE is a separate identifiable fund forming part of a life insurer. It must have first have become a PIE [see 1130.20] and have not ceased to be a PIE [see 1130.30]. It must hold investments subject to life insurance policies under which benefits are directly linked to the value of the investments held in the fund.

(5) Foreign investment PIE

Foreign investment PIEs were introduced to ensure that non-residents who invest in New Zealand collective investment vehicles are taxed on the same basis as they would be if they earned the investment income directly. Direct investment would result in no New Zealand tax being payable on non-New Zealand sourced income, and non resident withholding tax being payable on New Zealand sourced passive income, such as interest and dividends. In the absence of these measures, foreign investors are taxed at 28 per cent on all of their PIE income.

There are two categories of foreign investment PIE. These are the foreign investment zero-rate PIE and the foreign investment variable rate PIE.

The foreign investment zero-rate PIE has only foreign-sourced income, subject to a de minimis of five per cent of New Zealand sourced interest income and one per cent for New Zealand equity income. The interest income threshold is to allow the PIE to hold sufficient cash reserves to meet applications, redemptions and normal expenses. The equity income threshold is to allow the fund to track a global index and hold some New Zealand shares as a part of that.

The foreign investment variable rate PIE has both New Zealand and foreign sourced income. Different tax rates apply to different types of income:

<table>
<thead>
<tr>
<th>Income type</th>
<th>Tax rate %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign sourced income</td>
<td>0</td>
</tr>
<tr>
<td>Dividends from NZ equities to the extent imputed</td>
<td>0</td>
</tr>
<tr>
<td>Dividends from NZ equities to the extent un-imputed</td>
<td>15 (DTA)/30 (no DTA)</td>
</tr>
<tr>
<td>Gains on New Zealand equities</td>
<td>0</td>
</tr>
<tr>
<td>Interest income from NZ financial arrangements</td>
<td>1.44 (equivalent to net approved issuer levy rate)</td>
</tr>
<tr>
<td>Other NZ income</td>
<td>28</td>
</tr>
</tbody>
</table>

Income of a foreign investment PIE which is sourced from outside of New Zealand is not treated as having a source in New Zealand merely because the business of the PIE is carried on in New Zealand or the the contract in relation to the income (eg the purchase of the shares from which foreign dividends have been derived) was made or performed in New Zealand.

1130.20 Becoming a portfolio investment entity [ss HM 7, HM 8, HM 9, HM 10, HM 17, HM 18, HM 20, HM 71]

An entity can choose to become a portfolio investment entity (PIE) provided that it meets the eligibility requirements and files the appropriate election [s HM 7].

The eligibility criteria are as follows:
(a) The entity must choose to become a PIE and notify the CIR of the election under s HM 71;
(b) The entity must be a multi-rate PIE a listed PIE a benefit fund PIE or a life find PIE;
(c) The entity must maintain its eligibility to be a PIE in accordance with the rules in ss HM 8 to HM 20 and not lose its PIE status under the exit rules in ss HM 24 to HM 30;
(d) The entity must be resident in New Zealand and not be treated under a double tax agreement (DTA) as being a non-resident [s HM 8];
(e) The entity must be one (or more) of the following:
   (i) A company;
   (ii) Superannuation scheme;
   (iii) A group investment fund;
   (iv) A separate identifiable fund forming part of a life insurer; or
   (v) A trust that would be a unit trust if there was more than one subscriber, purchaser or contributor participating as beneficiaries [s HM 9]
(f) The entity must not be a life insurer unless it is a life fund PIE [s HM 10];
(g) Where the entity is not a life fund PIE all investor interests that give rights to proceeds must give the same rights in relation to all types of proceeds from the investment [s HM 17].

If the entity has ceased to be a PIE it cannot again become a PIE for a period of at least five years [s HM 20].

Note that a company that is not listed on a recognised exchange in New Zealand can become a listed PIE if it satisfies all of the following criteria:
(a) It has 100 shareholders or more;
(b) It has resolved to become a company listed on a recognised exchange in New Zealand if it were to obtain the required consents;
(c) It has applied to the Securities Commission for an exemption to disclose in a prospectus its intention to become a listed company; and
(d) It satisfies the CIR that the company would apply to become a listed company if it were to obtain the required consents.

If the company is not listed within two years of the election, it loses PIE status from the last day of that two-year period.

**1130.25 Election to become a portfolio investment entity** [ss, HM 71, HM 72, HM 75]

An entity can elect to become a PIE by giving notice to the CIR in accordance with s 31B of the Tax Administration Act. The election takes effect on the latest of the following dates:
(a) The date on which the entity is formed;
(b) The date nominated in the election notice; or
(c) Thirty days before the date on which the notice is received by the CIR.

Where an election to become a PIE has been made, the entity will become a PIE unless it cancels the election within 12 months or breaches any of the eligibility criteria [see 1130.30].

PIEs are generally required to have a standard balance date. Where an entity with a non-standard balance date becomes a PIE it has a transitional income year [see 770.70]. The transitional income year starts on the date on which the election to become a PIE takes effect and ends on the following 31 March.

On the day before an entity becomes a PIE it is deemed to have sold and reacquired, at market value, any shares that it holds (or for which it is a share lender) in New Zealand companies and certain Australian resident companies. This brings to account for tax purposes any notional gain or loss on the value of these investments.
The deemed disposal does not apply to shares in a company that is a PIE or becomes a PIE within the following six months.

Any tax liability that arises from:
(a) The requirement for a non-standard balance date entity to change to a 31 March balance date; or
(b) The deemed disposal and reacquisition of investment assets, is able to be spread evenly over the year in which the entity becomes a PIE and the following two income years. The provisional tax rules, use-of-money interest and the tax penalty rules do not apply to this income.

1130.30 Ceasing to be a portfolio investment entity [ss HM 25, HM 29, HM 72, HM 75; TAA, ss 2, 31B]

(1) Voluntary cessation
An entity can cease to be a PIE at any time by giving notice to the CIR in accordance with s 31B of the Tax Administration Act. The election takes effect on the latest of:
(a) The date on which the entity became a PIE;
(b) The date nominated in the notice; or
(c) The date on which the election is received by the CIR.

(2) Automatic cessation s HM 25
An entity ceases to be a PIE if it fails to meet eligibility criteria.
If, on the last day of a quarter, an entity, or one of its investor classes (as applicable) fails to meet any one or more of the requirements of:
(a) Section HM 11 (entity’s investment types);
(b) Section HM 12 (entity’s income sources);
(c) Section HM 13 (maximum shareholding in investments by entity or investor class);
(d) Section HM 14 (minimum number of investors in investor class); or
(e) Section HM 15 (maximum investor interest of an investor in an investor class)
and the breach is significant and within the control of the entity, and / or is not remedied by the last day of the next quarter, PIE status is lost from:
(a) For significant breaches within the control of the entity, the last day of that quarter;
(b) For other breaches that are not remedied by the last day of the following quarter, the last day of that second quarter.

There are two exceptions to the automatic loss of PIE status. They are:
(a) Where the start of the quarter in which the breach occurs is within six months plus one day of the date on which the entity becomes a PIE or the investor class is formed; or
(b) Where the quarter in which the breach occurs ends within three months prior to an announcement by the entity to its investors that the entity or the relevant investor class is to be wound up within the next twelve months.

Certain types of PIE can lose PIE status where a breach of criteria relating to the particular PIE type are breached. These are discussed under the paragraphs relating to those particular PIE types.

(3) Consequences of cessation
Cessation of PIE status results in a deemed sale and acquisition, at market value, of any shares held in New Zealand companies and Australian resident listed companies. These investments then lose their tax exempt status in respect of any future gain or loss on sale.
Multi-rate PIEs [ss HM 11, HM 12, HM 13, HM 14, HM 17, HM 21, HM 48]

An entity that has elected to be a portfolio investment entity (PIE), and which meets the criteria to be a multi-rate PIE will be a multi-rate PIE where the requirements below are met.

1. **Income interest requirement [s HM 17]**
   
The entity rules regarding investors’ interests must result in all investors having the same rights to all investment proceeds. This rule does not apply to category B income of a group investment fund.

2. **Investor membership requirements [ss HM 13, HM 14, HM 21]**
   
   Unless the entity is a listed company, every investor class within the entity must include one or more of the following:
   
   (a) Twenty persons (associated persons are treated as one person);
   
   (b) Another portfolio investment entity;
   
   (c) An entity that is eligible to be a PIE but has not elected to do so;
   
   (d) A foreign PIE equivalent;
   
   (e) A life insurer;
   
   (f) The New Zealand Superannuation Fund;
   
   (g) The Accident Compensation Corporation or Crown entity subsidiary of ACC;
   
   (h) The Earthquake Commission;
   
   (i) Auckland Council;
   
   (j) A boutique investor class which treats interests as being held by one person; or
   
   (k) A community trust. Where the entity is a listed on a recognised exchange in New Zealand, the above requirements do not apply. Instead the requirement is that the company is allowed only one investor class of which each investor is a member. This applies also to an unlisted PIE that meets the requirements of s HM 18 [see 1130.20].

   There are no investor membership requirements for:
   
   (a) Entities similar to unit trusts and certain superannuation funds; or
   
   (b) A portfolio investor class where any one or more of the following applies:
       
       (i) An investor in the class is a public unit trust;
       
       (ii) If it was a unit trust, it would meet the requirements of one or more of paragraphs (a) and (c) to (e) of the definition of public unit trust;
       
       (iii) It is a superannuation fund established under the restructuring proposal for the National Provident Fund;
       
       (iv) It is the fund established by the Government Superannuation Fund Act; or
       
       (v) It is a superannuation fund that existed before 17 May 2006 and, on or after 17 May 2006, meets the requirements of item (b)(i) above, and no investor in the class in question (other than the entity’s manager or trustee) can control the investment decisions relating to that class.

Section HM 25 provides some limited exceptions to these rules.

3. **Investor return adjustment requirement [s HM 48]**
   
The entity must make adjustments to each investor’s interests to reflect the effect of the investors’ tax rate on the total tax payable by the entity and the allocation of tax credits. The CIR has the power to extend the time limit for making the adjustment.
Portfolio Investment Entities (PIEs) 1130.35(4)

(4) Investment type criteria [s HM 11]
A multi-rate PIE must generally have at least 90 per cent (by value) of its investments in one or more of the following:
(a) Land;
(b) Financial arrangements;
(c) Excepted financial arrangements; or
(d) Rights or options concerning any of the above three categories of investment.
Neither the multi-rate PIE nor any investor class may hold a voting interest of 20 per cent or more in any underlying company into which it has invested. Section HM 25 provides some limited exceptions to these rules [see 1130.30].

(5) Income type requirement [s HM 12]
A multi-rate PIE must generally derive at least 90 per cent of its income from one or more of the following:
(a) Dividends;
(b) Financial arrangement income;
(c) Land rental from a non-associated person;
(d) Foreign investment fund income;
(e) The proceeds of property dispositions;
(f) Replacement payments under a returning share transfer;
(g) Income allocated to it by another PIE; or
(h) Distributions from superannuation funds.

Ceasing to meet the requirements results in the entity ceasing to be a PIE if the requirement is not again met within certain prescribed time-frames.

1130.40 Tax payable by multi-rate PIEs [ss CB 26, CW 9, CX 55, HM 42, HM 42B, HM 62, HM 63, HM 65, HM 75]
The normal rules of income and deductions apply to multi-rate PIEs. However, there are some differences in relation to the sale of shares and the receipt of dividends from foreign companies. These differences are explained below.

(1) Sale of shares [s CX 55]
Gains on the sale of shares other than non-participating redeemable shares, are excluded income, and therefore not subject to tax, provided that the shares are issued by a company which is either:
(a) Resident in New Zealand, and not treated by a double tax agreement (or equivalent) as being not resident in New Zealand, at all times during the income year; or
(b) Resident in Australia (and not treated under a double tax agreement as not being resident in Australia) at all times during the income year, included in an approved index under the ASX Market Rules either at the start of the income year or at the time at which the shares are first acquired, and required to maintain a franking account.

The concession does not apply where an arrangement has been entered into with another person whereby a gain on sale of the shares is assured. Neither does it apply to non-participating redeemable shares.
This treatment applies to all types of PIE, the New Zealand superannuation fund and to life insurers that elect to be a portfolio investment-linked life fund.

There are anti-avoidance rules which cover the disposal of shares “cum dividend”. Where this occurs, the entity is taxable on the amount of the dividend in respect of the shares that have been sold to the extent to which the dividend is not imputed [s CB 26]. The formula for calculating the taxable amount is:
(shares at declaration – shares on distribution) × dividend

Where:
“Declaration shares” is the number of shares held when the dividend is declared;
“Distribution shares” is the number of shares for which the entity derives a dividend; and
“Distribution” is the amount of the dividend per share or, for a share issued by an ICA company, the amount
of the dividend that is not fully imputed.

(2) Dividends derived from foreign companies [s CW 9]
The exemption from tax for dividends derived by a New Zealand resident company from a foreign company
does not apply to a dividend derived by a multi-rate PIE.

(3) Calculation of tax payable by a multi-rate PIE [ss HM 31, HM 34, HM 35, HM 35B, HM 36, HM 43, HM 47]
The income of the multi-rate PIE is allocated to the entity’s investors and the tax payable on that income is
calculated at the marginal tax rates of those investors. In order to achieve this, each multi-rate PIE must elect
a calculation period and an attribution period.
The attribution period is the period over which income, expenses, losses and tax credits are calculated and
allocated to investors. The entity can choose a period of a day, month, quarter or income year. The default
attribution period is a day.
The amount of the attributed PIE income or loss for each investor for each income year is the total of the
amounts calculated for:
a Each attribution period in the income year; and
b Each day in the attribution period; and
c Each investor class to which the investor belongs on the day.
These amounts are calculated using the formulae in ss HM 35 and HM 36:
Section HM 35 provides for the calculation of the net income or loss which is then attributed to the investors
who are part of that investor class. The formula is:
assessable income - deductions
Where:
“Assessable income” is the total amount of the PIE’s assessable income (including any tax credits received
for that income) attributed to the class for the attribution period; and
“Deductions” is the total amount of the PIE’s deductible expenditure or loss attributed to the investor class
for that attribution period.
When calculating “assessable income” and “expenditure”, the PIE is able to take into account certain future
income amounts which it is likely to have, and provisions that it has made for future expenditure or loss. Any
amount included must be either reflected in the PIE’s valuation of portfolio investments or be shown in its
financial statements. Any future income that is included must be income that would be assessable income
under the formula when it is derived. Any expenditure included must be an expense that is likely to be incurred
in the tax year in which the attribution period falls or within 893 days thereafter. Reasonable estimates of the
amount are permitted. A credit impairment provision is able to be included only where it is a credit impairment
provisions under NZIAS 39. [s HM 35B].
The net result is then allocated to each investor within the class using the formula contained in s HM 36:
(percentage x (income - loss)) / days in period - (expenses - credits for fees)
Where:
“Percentage” is the percentage of the investor’s entitlement to a distribution by the PIE to the investor class;
“Income” is the amount of taxable income determined under s HM 35(5) and (7) for the period (see above);
“Loss” is the amount of tax loss determined under s HM 35(5) and (7) for the period;
“Days in period” is the number of days in the period;
“Expenses” is the total amount for the day in the period of management and administration fees attributable to the investor as a member of the investor class plus expenditure transferred to the PIE under subpart DV and attributable to the investor (eg a transfer of expenditure to a master fund);
“Credits for fees” is the amount of any credit for the fee paid or credited by the PIE to the account of the investor as a member of the investor class on the day in the period. Note that, if the multi-rate PIE has income or property in which no investor has an interest or conditional entitlement, the PIE is treated as the sole investor in an investor class having an interest in that property or income.

The tax payable is then calculated for the calculation period. The calculation period can consist of one or more attribution periods. The entity can choose a period of a day, quarter or income year. The default calculation period is a quarter. The tax payable by the multi-rate PIE for the calculation period is the sum of the liabilities calculated for each investor for each attribution period. If the calculation period is a quarter, the tax is payable within one month of the end of the quarter and the provisional tax regime does not apply. If an investor exits, the multi-rate PIE is not required to pay tax in relation to that investor if that liability exceeds the value of any remaining interest of that investor. In these cases, the investor is required to return the income at the end of the year. If the calculation period is a year, the provisional tax regime applies in the normal way [see 1150 PROVISIONAL AND TERMINAL TAX].

If the calculation period is a day, tax is payable when an investor exits the entity. The tax is payable within one month of the end of the exit period. In respect of other investors, tax is payable within one month of the end of the tax year. If the multi-rate PIE incurs a loss that it allocates to its investors, the entity receives a rebate of tax. Exiting investors are, under certain circumstances, entitled to a deduction for their share of a loss incurred by a multi-rate PIE.

The amount of tax payable by the multi-rate PIE is calculated under s HM 47 and is the sum of the amounts for:

(a) Each investor class in which the investor has an interest;
(b) Each investor in an investor class;
(c) Each attribution period in the calculation period; and
(d) Each day in an attribution period.

The formula for the calculation is:

\[
\text{rate} \times \text{amount}
\]

Where:

“Amount” is the net income or loss (see above).
“Rate” is the investor’s tax rate or 28 per cent to the extent to which the PIE is the sole investor.

Example:

A multi-rate PIE has two investors, each having a 50 per cent interest in the fund. Investor A has a 10.5 per cent tax rate. Investor B has a 30 per cent tax rate. The income of the fund for the day is $20,000. Management fees for the day are $500. The entity has elected an allocation period of one day.

The income attributable to each investor is $(20,000 - $500) x 50\% = $9,750.

The tax payable is the sum of:
Investor A: $9,750 x 10.5\% = $1,023.75
Investor B: $9,750 x 28\% = $1,023.75 = $2,730.00

The total tax payable in respect of that day is $1023.75 + $2730.00 = $3,753.00.

These daily amounts are accumulated for the calculation period, which will generally be a quarter. Multi-rate PIEs are not able to form a group of companies. This means that they are ineligible for group loss offsets.
Exiting investors

An investor exits a PIE when the value of the investor’s interest reaches the exit level. This occurs when the PIE’s tax liability for the investor exceeds, or is equal to, the value of the investor’s interest [s HM 62].

Where an investor has reached the exit level during a tax year, the PIE must perform an exit calculation for the investor’s exit period. The exit period begins on the later of the first day of the tax year and the day on which the investor last became an investor. The period ends on the day on which the investor’s interest reaches the exit level. Where the PIE uses the quarterly calculation option, and does not voluntarily pay the tax, the exit period is the quarter in which the exit level is reached plus a five-working-day period of grace [s HM 63].

Land losses [s HM 65]

Where an investor class of a multi-rate PIE has a land loss for a calculation period, that loss can be carried forward provided that the PIE calculates and pays tax using the exit calculation option or the quarterly calculation option.

A “land loss” is a tax loss of an investor class for a calculation period where the following criteria are met:

(a) At the end of the calculation period, the class has an entitlement to the distribution of proceeds of the PIE’s investments; and
(b) Those investments have a value of more than 50 per cent of the market value of all of the PIE’s investments in which the class has the entitlement; and
(c) the investments fall into one or more of the following types:
   (i) An investment in land;
   (ii) An investment in a land investment company that is resident in New Zealand;
   (iii) An investment in a non-resident land investment company in which the investor class has a voting interest of more than 20 per cent.

Payment of tax [s HM 42]

PIEs are required to pay tax for each period in the income year and for each investor.

The tax attributable to exiting investors is required to be paid within one month after the end of the month of withdrawal. If the month of withdrawal is November, the tax must be paid by the following 15 November.

The tax attributable to investors other than exiting investors, is payable at the end of the tax year.

Tax treatment of investors in multi-rate PIEs [ss CX 56, CX 56B]

Investors in multi-rate PIEs elect a tax rate (called a “notified rate”) based on their “prescribed investor rate”. In simple terms, the prescribed investor rate is a little bit like a deemed marginal tax rate (but only for the purposes of the options for taxing income in a multi-rate PIE). The notified rate is the rate that the person advises to the multi-rate PIE.

The prescribed investor rates are set out in sch 6 of the Income Tax Act. Currently the rates are 28 per cent, 17.5 per cent and 10.5 per cent. For all investors who do not notify the multi-rate PIE of the tax rate that they have elected, the default rate applies, being 28 per cent.

Investigators in multi-rate PIEs have attributed PIE income or losses under subpart HM and s CP 1. Section CX 56 provides that the amount of any attributed PIE income is treated as excluded income to natural person investors who elect a rate that is no lower than their prescribed investor rate. This means that, provided investors have advised the correct rate to the multi-rate PIE they do not need to include the allocated PIE income in their tax return. If the incorrect rate is advised to the multi-rate PIE any allocated PIE income is not treated as excluded income and must be included in the person’s income tax return.

Income allocated by multi-rate PIEs does not affect entitlements to family assistance (under Working for Families). This is the case whether or not the correct tax rate has been notified to the multi-rate PIE.
Allocated PIE income is not excluded income for zero-rated investors (and certain exiting investors in entities paying tax under s HM 43). This income must be included in the investor’s tax return. Under s DB 53, these investors are allowed a deduction for the amount of any allocated PIE losses.

Allocated PIE losses relating to non-zero rated investors under ss HM 40 and HM 55 are available as a tax credit to the entity under s HM 55. Investors cannot claim these losses.

Any tax credits received by a multi-rate PIE must first be used against the tax liability of the entity. Any excess tax credits, other than foreign tax credits, are allowed as a rebate either to the entity or to the investor, in the case of zero-rated portfolio investors. Entities that receive a rebate must credit the rebate to investors’ accounts. Foreign tax credits are not rebated and must be used in the income year in which they are derived.

Trustees of trusts must choose between four options. They can:
(a) Elect the zero per cent prescribed investor rate and notify the multi-rate PIE of their election;
(b) Elect the 10.5 per cent rate;
(c) Elect the 28 per cent prescribed investor rate; or
(d) Choose to have the default rate of 28 per cent apply (by not electing a rate).

Making the correct choice is critical to the tax outcome for the trustees and beneficiaries of the trust.

If the zero per cent rate is elected, income distributed by the multi-rate PIE will not be excluded income. It can be either be returned as trustee income and taxed as such or can be distributed as beneficiary income and be returned in the beneficiaries’ tax returns. Any allocated tax credits retain their character.

If the intermediate rate is elected, income distributed by the multi-rate PIE will not be excluded income. It can be either returned as trustee income and taxed as such or can be distributed as beneficiary income and be returned in the beneficiaries’ tax returns. Any allocated tax credits retain their character. The trustees are allowed a credit for tax paid at the PIE level.

If the highest rate is elected, income distributed by the multi-rate PIE will be excluded income. It cannot be trustee income and cannot be taxed as beneficiary income. Therefore, the 28 per cent tax paid by the multi-rate PIE is a final tax.

If no election is made, the default rate applies. Income distributed by the multi-rate PIE will not be excluded income. It can be either be returned as trustee income and taxed as such or can be distributed as beneficiary income and be returned in the beneficiaries’ tax returns. Any allocated tax credits retain their character. However, they are non-refundable tax credits. Therefore, unless the trustees (if the distribution is retained as trustee income) or the beneficiaries (if the distribution is distributed to beneficiaries) have sufficient other refundable tax credits (ie PAYE or RWT) more tax than necessary may be paid on the income.

The CIR is able to notify a PIE that investor’s notified rate is to be ignored and prescribe a different rate that the PIE must apply to that investor [s HM 60].

1130.50 Tax treatment of investors in portfolio investments entities that are not also multi-rate PIES [s CX 56C]

Distributions and dividends from portfolio investment entities that are not also multi-rate PIEs are excluded income in the hands of the investor where all of the following conditions are met:
(a) The investor is a natural person or a trustee;
(b) The investor is a New Zealand resident for tax purposes; and
(c) The investor does not include the amount as income in a return of income for the income year.

In all other cases, the dividend or distribution is excluded income of the investor to the extent to which it is not fully covered by imputation credits.

1130.55 Listed PIES [s HM 2]

A listed PIE is a company that is listed on a recognised exchange in New Zealand and which is a portfolio investment entity. A listed PIE can elect to be a multi-rate PIE if it meets the relevant criteria [s HM 2]. Where
that election is not made, a listed PIE does not allocate income to investors. It pays tax at a flat rate of 30 per cent (28 per cent from the 2011-2012 income year).

A listed company is eligible to be a listed PIE where:

(a) It satisfies the requirements to be a portfolio investment entity [see 1130.20];
(b) It makes the appropriate election [see 1130.25]; and
(c) All of the requirements below are met:

(1) **Income interest requirement** [s HM 17]
The income interest requirement is the same as that applying to multi-rate PIEs [see 1130.35].

(2) **Membership requirement** [s HM 14]
The membership requirement is the same as that applying to multi-rate PIEs [see 1130.35]. However, the following requirements must also be met:

(a) The company must have only one investor class of investors;
(b) Each investor must be a member of the investor class; and
(c) Each investor interest must be a share traded on the recognised exchange.

(3) **Imputation credit distribution requirement** [s HM 19]
Where the listed PIE is an imputation credit account company and not a life fund PIE all distributions to members must be fully credited to the extent possible, limited only by the amount of ICA credits available.

(4) **Investor interest size requirement** [s HM 15]
The investor interest size requirement is the same as that applying to multi-rate PIEs [see 1130.35].

An investor who is not one of those listed in any of items (a) to (i) in 1130.35, can hold investor interests in the listed PIE that are more than 20 per cent. However, those interests must not exceed 40 per cent and must be between 20 per cent and 40 per cent on every day from 17 May 2006.

(5) **Investment type requirement** [s HM 11]
The investment type requirement is the same as that applying to multi-rate PIEs [see 1130.35].

### Distributions from listed PIEs [s CX 56C]
Distributions from a listed PIE are excluded income of the investor only where the investor:

(a) Is a resident;
(b) Is a natural person or a trustee; and
(c) Does not include the amount as income in their return for the year.

Where the above three conditions are met, the tax treatment of distributions from a listed PIE are similar to the treatment of distributions from a qualifying company. The income is assessable only to the extent to which it is fully imputed or fully dividend withholding payment credited.

### Benefit fund PIEs
A benefit fund PIE is a defined benefit fund that is a PIE that does not allocate income to investors. A defined benefit fund is a superannuation scheme that is registered under, and complies with, the Superannuation Schemes Act 1989 [SSA 1989, s 15(1)(a)].

Benefit fund PIEs pay tax at a flat rate of 30 per cent (28 per cent from the 2011-2012 income year). The investor membership requirement, the investor interest size requirement, the investment type requirement and the income type requirement are the same as those applying to multi-rate PIEs [see 1130.35].

### Life fund PIEs
A life fund PIE has the following characteristics:
(a) It is a separate identifiable fund which is part of a life insurer;
(b) The fund holds investments which are subject to life insurance policies under which benefits are
directly linked to the value of the investments in the fund;
(c) The entity must be resident in New Zealand and not treated under a double tax agreement (DTA) as
not being resident in New Zealand; and
(d) The entity must not have ceased to be a portfolio investment entity (PIE), five years or less prior to
the effective date of an election to become a PIE [see 1130.25].

The investor membership requirement, the investment type requirement and the income type requirement
are the same as those applying to multi-rate PIEs [see 1130.35].
Chapter 1140
Prepayments

1140.10 Deferral of deductions for prepaid expenditure [ss CH 2, DB 50, EA 3; TAA, s 91AA]
The role of the rules relating to prepaid expenditure is to ensure that the deduction for expenditure is matched as nearly as possible with the income that it generates. This is achieved by deferring the deduction to the extent to which the goods, services or rights to which it relates have not been consumed (the “unexpired portion”). The mechanism by which that result is achieved is to deem the prepaid amount to be income in the year of prepayment and an allowable deduction in the following year. That mechanism is applied for one or more years until such time as the goods, services or rights have been consumed.

These rules are not intended to override or alter existing specific deduction provisions, such as film expenditure or farm or forestry development expenditure.

The rules do not apply to expenditure incurred on:
(a) Purchase of trading stock;
(b) Purchase of revenue account property;
(c) Purchase of livestock;
(d) Any financial arrangement or excepted financial arrangement that is subject to its own valuation rules;
(e) Leases of personal property (whether or not a specified lease);
(f) Property resulting from petroleum exploration or development expenditure; or
(g) Any film or film right

The calculation of the amount that is required to be added back to income differs according to whether the amount relates to:
(a) Goods;
(b) Services;
(c) Choses in action; or
(d) Monetary remuneration.

1140.20 Goods — unexpired portion [s EA 3(4)]
The term “goods” includes all land and other real or personal property, but does not include choses in action or money. “Goods” also includes items which are consumable aids (being items which are consumed in the operating, manufacturing, or sales procedure, but which do not form part of the item received by the customer, eg sandpaper or solvents in a boat builder’s business, and fertiliser purchased by a farmer taxpayer but not applied).
PIB 167 (December 1987) endeavours to extend the phrase “expenditure which relates to the purchase of goods” to “the costs associated with the purchase, such as brokerage, Government imposts, solicitors’ and agents’ fees and delivery costs. It therefore includes the cost of certain services”. It appears that the ultimate purpose of the expenditure is to be considered.

Land is specifically excluded from the definition of “trading stock” for the purposes of the normal trading stock rules. However, it can be subject to the timing rules applicable to revenue account property under s EA 2 [see 880.90]. It is not subject to the rules in s EA 3.

Where the expenditure relates to the purchase of goods, the unexpired portion of the expenditure is the amount incurred on goods that have not been used in the derivation of income, or destroyed, or rendered useless. PIB 167 (December 1987) has described “used” for a good, as meaning applied, consumed, put into operation, or otherwise employed, in the process that produces gross income. It is not sufficient that it be available for use and, in particular, it is not sufficient that the goods be available for examination or sale.

### 1140.30 Services — unexpired portion [s EA 3(5)]

“Services” means anything which is not goods, money, or a chose in action.

Where the expenditure relates to payment for services, the unexpired expenditure is the amount incurred on services which have not yet been performed as at the end of the income year. PIB 167 (December 1987) advises that services are performed:

“where and to the extent that they are executed, carried out or otherwise rendered. Where they are to be performed over a period of time there must be an apportionment if the time period includes a balance date. The reference to ‘services not yet performed’ indicates clearly that the apportionment must be on the basis of the services yet to be performed compared with the total services to be performed in consideration for the expenditure, rather than on a simple time basis.”

PIB 167 (December 1987) provides that prepayment for services includes:

(a) The price paid for the services; and

(b) Costs related to the services, such as any solicitors’ fees or Government or local body levies.

### 1140.40 Choses in action — unexpired portion [s EA 3(6)]

A “chose in action” is not defined but is a legal term for something enforceable by legal action, and which is a contractual obligation (eg royalty rights).

PIB 167 (December 1987) describes a chose in action as:

“… literally a thing recoverable by legal action. Its modern use is to describe all personal rights of property that may be claimed or enforced by legal action including rights for real property.”

For example, it would include a three-year lease for a building.

Where the expenditure relates to a payment for, or in relation to, a chose in action, the unexpired expenditure is the amount that relates to the unexpired part of the period for which the chose is enforceable. PIB 167 (December 1987) interprets these words and places emphasis on more than a time expired basis:

“one must consider the rights that may be exercised for the part period. For example where an agreement provides for use of patent rights and it is expensed with reasonable certainty (or is provided in the agreement) that the use of the patent rights will be:

“(a) 15,000 units produced in the 6 months prior to balance date; and

“(b) 85,000 units produced in the 6 months after balance date.

“The apportionment to calculate the unexpired portion will be on an output basis (85% of the accrual expenditure) rather than a simple time basis.”
Prepayments

1140.50 Employment income and employee benefits [ss CH 3, DB 51, EA 3(7), EA 4]

While the rules relating to prepayments concentrate on payments made for goods not yet used, services not yet performed and choses in action not yet expired, the rules relating to expenditure on employment income work in reverse by concentrating on deferred payment.

Under the principles set out in King Country Electric Power Board v Commissioner of Inland Revenue (1995) 17 NZTC 12,122 (HC), employment income is “incurred”, and the deduction allowed, at the time at which the employee becomes unconditionally entitled to payment for the leave.

The amount that is a deferred payment and which is required to be added back to income is:

(a) In the case of an employee, the amount that has not been “paid” during the income year or within 63 days following the end of the income year; or
(b) In the case of a shareholder-employee, the amount that has not been “paid” by the employer company during the income year or by the following 31 March (being the last date for filing a return of income under the extension of time rules).

The term “paid” includes credited in account or dealt with in the interest or on behalf of the person.

Example:

Boss Co has one employee, Mary. Mary has been employed by Boss Co for 11 years. At the end of Boss Co’s financial year, Mary has the following holiday entitlements:

<table>
<thead>
<tr>
<th>Annual leave</th>
<th>15 days @ $200</th>
<th>$3,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>10-year long service leave</td>
<td>15 days @ $200</td>
<td>$3,000</td>
</tr>
</tbody>
</table>

When Mary completes fifteen year’s continuous service, she will be entitled to a further long service leave of 10 days, which Boss Co is accruing on an annual basis. The accrual to date is two days at $200 per day. Mary takes five days’ annual leave in the month following the end of Boss Co’s financial year but takes no more leave for a further six months.

Boss Co will not be entitled to a deduction for $400 accrual in respect of Mary’s 15-year long service leave as she is not yet definitively entitled to it and, therefore, the expenditure has not been incurred.

The expenditure in respect of Mary’s annual leave and 10-year, long service leave has been incurred and is deductible. However, all of the accrual other than five days of the annual leave entitlement constitutes a deferred payment. Therefore, Boss Co will have income of $5,000 ($3,000 for 10-year long service leave, plus $2,000 for annual leave) under the prepaid expenditure rules. The amount will be deductible in the following income year subject to any further requirement to defer the taking of the deduction.

Where expenditure relates to:

(a) Employee reimbursements or expenditure on account under s CW 17;
(b) Relocation allowances under s CW 17B;
(c) Overtime meal or sustenance allowances under s CW 17C; or
(d) Allowances for additional transport costs under s CW 18;

the prepayment rules apply on the basis that the relevant services were performed in the income year in which the employee’s expenditure is expected to occur. This means that, if the employee’s expenditure is expected to occur in prior to the employer’s balance date, no income arises for the employer under the prepayments provisions.

1140.60 Employee transfers [ss DC 10, DC 11, EA 4(4), (5), (6), (7)]

Where a business or part of a business has been sold, actual and contingent expenditure on employment income is treated as having been paid by the vendor at the time of sale and, therefore, is not required to be added back to income. The vendor does not obtain a deduction when the amount is eventually paid to the employee. For this treatment to apply, all of the following conditions must be satisfied:

(a) The buyer and seller are not associated persons at the time of sale;
(b) The obligation to pay the employment income has arisen in the course of the business;
(c) Under the sale arrangements, the employee becomes an employee of the purchaser of the business;
Prepayments

(d) The seller and the buyer agree in writing that the purchaser will assume the responsibility of paying the employee; and

(e) The seller and buyer have agreed in writing that the amount is reflected in the consideration paid by the buyer for the business.

If all of the conditions are met other than the requirement that the parties not be associated, the vendor is denied a deduction for amount but the purchaser will generally be entitled to a deduction at the time at which the employee is paid.

Where employees transfer other than on the sale of a business, the employer from which the employee is transferring is denied a deduction for any liability for employment income which is unpaid. The employer to which the employee transfers will generally be entitled to a deduction for the amount when it is eventually paid to the employee.

For the timing of deductibility of accident compensation premiums and interest payable under an instalment plan under the Accident Insurance Act 1998 [see 20 ACCIDENT COMPENSATION].

1140.70 Exemptions from accrual adjustments [ss EA 3; TAA, s 91AA]

The CIR has the discretion to excuse taxpayers from the requirements of the prepayments provisions. Determination E12 specifies the type of expenditure, amount, and the maximum period from balance date, for which adjustments are not required [see TIB vol 21:2 (April 2009) at 13]. Determination E12 provides that any expenditure taken into account in making a joint return of income of a partnership is treated as if the expenditure were incurred by the partnership and not by any other person.

Determination E12 provides that a person who incurs expenditure that is deductible in any income year ending on or after 1 April 2009, is not required to make accrual adjustments in respect of the expenditure and the income year, if:

(a) The expenditure is of a kind described in Column 1;

(b) The sum of all of the amounts of the unexpired portion of the kind of expenditure does not exceed the amount, if any, specified in relation to that expenditure in Column 2;

(c) The length of time between the balance date for the income year and the subsequent expiry date of the expenditure does not exceed the number of months (if any), specified in relation to the expenditure in Column 3; and

(d) The deduction of the expenditure has not been deferred to a subsequent income year for financial reporting purposes.

<table>
<thead>
<tr>
<th>Description of expenditure</th>
<th>Total amounts of unexpired portion</th>
<th>Number of months</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Column 1</strong></td>
<td><strong>Column 2</strong></td>
<td><strong>Column 3</strong></td>
</tr>
<tr>
<td>(a) Rental for the lease of land or buildings relating to a period ending more than one month after balance date</td>
<td>$26,000</td>
<td>6</td>
</tr>
<tr>
<td>(b) Rental for the lease of land or buildings other than such rental dealt with elsewhere in this determination</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>(c) Rental for the lease or bailment of livestock or bloodstock</td>
<td>$26,000</td>
<td>6</td>
</tr>
<tr>
<td>(d) Payment for purchase of consumable aids which are in the possession of the person as at balance date</td>
<td>$58,000</td>
<td></td>
</tr>
<tr>
<td>(e) Insurance premiums under an insurance contract if the total amount of such expenditure incurred in the income year in respect of the contract does not exceed $12,000</td>
<td></td>
<td>12</td>
</tr>
<tr>
<td>(f) Payment in respect of equipment service contracts or warranties if the consideration for the contract or warranty forms an</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Staples Tax Guide 2012
## Description of expenditure

<table>
<thead>
<tr>
<th>Description of expenditure</th>
<th>Total amounts of unexpired portion</th>
<th>Number of months</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Column 1</strong></td>
<td><strong>Column 2</strong></td>
<td><strong>Column 3</strong></td>
</tr>
<tr>
<td>inseparable and indeterminate part of the consideration for the asset or assets to which it relates</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(g) Payment in respect of a contract for the service or maintenance of plant, equipment, or machinery if the total amount of such expenditure incurred in the income year in respect of the contract does not exceed $23,000</td>
<td>$14,000</td>
<td>3</td>
</tr>
<tr>
<td>(h) Payment for the use or maintenance of telephone and other communication equipment</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>(i) Costs for services, other than those dealt with elsewhere in this determination</td>
<td>$14,000</td>
<td>6</td>
</tr>
<tr>
<td>(j) Periodic charges, other than those dealt with elsewhere in this determination</td>
<td>$14,000</td>
<td>12</td>
</tr>
<tr>
<td>(k) Purchase of stationery</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(l) Subscriptions for a newspaper, journal, or other periodical including the maintenance or annotation of a documentary information service</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(m) Motor vehicle registration and drivers licence fees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(n) Subscriptions, or other fees (but excluding any payment in respect of a franchise agreement) entitling membership of any trade, professional, or other association if the amount of such expenditure incurred in the income year in respect of the association does not exceed $6,000</td>
<td>$14,000</td>
<td>12</td>
</tr>
<tr>
<td>(o) Costs on postal and courier services, including such expenditure for franking, private postboxes and private postbags, business reply post and freepost, and expenditure evidenced by the possession of postal stamps</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(p) Rates made and levied under Part 3 of the Local Government (Rating) Act 2002 to the extent of the amount invoiced on or before balance date</td>
<td>$14,000</td>
<td>6</td>
</tr>
<tr>
<td>(q) Advance bookings for travel and hotel or motel accommodation</td>
<td>$14,000</td>
<td>6</td>
</tr>
<tr>
<td>(r) Costs of advertising</td>
<td>$14,000</td>
<td>6</td>
</tr>
<tr>
<td>(s) Road-user charges</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(t) Audit fees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(u) Mandatory accounting costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(v) Expenditure that is deductible under s DB 3(1) (cost of determining tax liabilities) and which is not excluded by s DB 3(2)</td>
<td>$14,000</td>
<td>6</td>
</tr>
<tr>
<td>(w) Direct claim settlement costs included in the outstanding claims reserve of a general insurer in relation to a contract of insurance if the total gross claim cost (excluding GST) included in the</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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Prepayments

1140.80

<table>
<thead>
<tr>
<th>Description of expenditure</th>
<th>Total amounts of unexpired portion</th>
<th>Number of months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Column 1</td>
<td>Column 2</td>
<td>Column 3</td>
</tr>
<tr>
<td>outstanding claims reserve in relation to any one claim does not exceed $65,000 (excluding GST)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1140.80 Cost of revenue account property [s EA 2]

Section EA 2 deals with the timing of deductions for expenditure incurred on revenue account property and aims to match the timing of the deduction with the associated income. Revenue account property is defined to include property that, if it was disposed of for valuable consideration, would produce income for the person (other than by way of a depreciation recovery).

The deduction for the cost of revenue account property is allowed in the earlier of:

(a) The income year in which the taxpayer disposes of the property; and
(b) The income year in which the property ceases to exist.

These rules do not cover the timing of expenditure that is subject to timing rules elsewhere in the Act such as trading stock, livestock, financial arrangements, excepted financial arrangements, leases, petroleum exploration and development expenditure, and films and film rights.
Chapter 1150

Provisional and Terminal Tax

1150.05 Overview

Taxpayers who earn income that is not subject to deduction at source (ie business income), are required to meet their tax obligation for that income by paying provisional tax. Provisional tax is required to be paid when their residual income tax (RIT) for the previous tax year exceeds $2,500, although it can also be paid voluntarily. From the 2008-2009 tax year, provisional tax payments are aligned with GST payment dates. Prior to the 2008-2009 tax year, different payment dates applied [see 1150.40].

Provisional tax can be calculated using either the standard (uplift method) or the estimation method [see 1150.15 to 1150.20].
Certain taxpayers are required to pay provisional tax [s RC 3] and others may choose to pay [s RC 4]. The amount of provisional tax paid by a provisional taxpayer for a tax year is credited against the provisional taxpayers income tax liability for that year [s LB 2]. If the provisional tax is insufficient for any particular year, then the insufficient amount is called terminal tax. On the other hand, if the provisional tax was excessive in relation to the amount of tax that was required, then the excessive amount constitutes a refund.

See Inland Revenue’s Booklet Provisional Tax (IR289).

**1150.10 Definitions**

“Provisional taxpayer” means any taxpayer whose residual income tax (RIT) for the tax year is $2,500 or more, or who is entitled to make an election to be a provisional taxpayer under s RC 4 [see 1150.50], but does not include:

- A non-resident company that does not have a fixed establishment in New Zealand;
- A taxpayer not required to file a return of income by virtue of s 33A of the TAA [see 1270.70]; or
- A non-resident contractor;
- A portfolio tax rate entity that does not make an election under s HL 23 [s RC 3]

“Residual income tax” (RIT) means the positive amount (if any) that remains after subtracting from the person’s income tax liability for the income year (net of any refundable rebates):

- Any credit of tax allowable for tax paid by a trustee on behalf of a beneficiary or by an agent on behalf of a principal;
- Any credit allowed against the income tax liability for:
  - PAYE or withholding tax deductions;
  - RWT deductions;
  - NRWT;
  - Imputation credits or FDP credits;
  - Foreign taxes paid
  - Attributed foreign income tax credits allowed;
  - Tax Credits by group companies;
  - Maori Authority tax credits

When RIT is calculated no deduction is made for provisional tax paid during that year.

A provisional taxpayer with an “initial provisional tax liability” means any provisional taxpayer who:

- Is not a natural person or is a natural person trustee; and
  - First derived gross income from a taxable activity in that tax year; and
  - Has not in any of the four preceding tax years derived gross income from a taxable activity; or

- Is a natural person other than a trustee; and
  - Their RIT has not exceeded $2,500 in any of the four preceding years;
  - Their RIT exceeded $35,000 in the current tax year; and
  - During the current tax year, the taxpayer has ceased to derive employment income and subsequently commenced to derive gross income from a taxable activity.

“Taxable activity” has the meaning given to that term by s 6 of the GSTA 1985, except that s 6(3)(d) does not apply [see 580.95].
1150.12 Calculation of provisional tax [s RC 5]

There are three different methods that can be used to calculate the amount of provisional tax payable: the standard (uplift) method [see 1150.15], the estimation method [see 1150.20], and the GST ratio method [see 1150.21]. Also, in certain circumstances, the CIR may make a determination of the amount of provisional tax payable by a taxpayer [see 1150.65].

1150.15 Standard (uplift) method [ss RC 5, RC 6]

There are two methods with the standard method; the standard five per cent uplift and the standard 10 per cent uplift. Under either the five per cent or 10 per cent standard uplift method, the amount of provisional tax payable is calculated as at the date the instalment is due by multiplying the RIT for either the preceding tax year [see 1150.18] or for the year before the preceding tax year by either 105 per cent or 110 per cent respectively. In relation to RIT adjustments for current tax rate changes see 1150.18.

The particular uplift percentage for a particular instalment is determined as follows:

(a) If the income tax return for the preceding tax year has been filed by the date the instalment of provisional tax is due, then the provisional tax is based on 105 per cent of the RIT for the preceding tax year.

(b) If all of the following conditions are met, provisional tax for an instalment is based on 110 per cent of the RIT for the year before the preceding tax year:
   (i) A tax return was required for the preceding tax year;
   (ii) The return is not due on or before the date on which the first payment of provisional tax for the tax year is required or an extension granted under s 37 of the TAA [see 1270.61];
   (iii) The return is not provided on or before that date;
   (iv) The date is not the date of instalment F for the corresponding income year; and
   (v) The taxpayer has not chosen to furnish an estimate of provisional tax, and the CIR has not determined the amount of provisional tax.

If the CIR determines the provisional tax liability under s 119 of the TAA, the amount or liability is that last determined by the CIR and notified to the taxpayer at least 30 days before the instalment date. The 30-day requirement does not apply when, under s 119(1)(d) of the TAA, the estimate of residual income tax is not fair and reasonable [s RC 5]. If the tax return for the previous tax year has not been filed by the due date for the final instalment, that instalment must be based on an estimate. If no amount has been paid on an instalment date, penalties and use of money interest will apply to the short paid amount.

**Note:** To reduce penalty and use of money interest exposure it is prudent that an amount is paid on account of current tax on the instalment date. This need not be stated to be an estimate.

The following examples do not take account of current tax rate changes, referred to in 1150.18 and 1190 RATES OF TAX).

**Example 1:**
A company with a standard balance date filed its 20X1-X2 tax return on 18 May 20X2 (before the due date for instalment 1 for 20X2-X3). The company’s RIT for 20X1-X2 was $25,340. Assuming the company does not elect to use the estimation method, the company’s provisional tax for 20X2-X3 will be 105 per cent of its previous year’s RIT. Provisional tax for the 20X2-X3 tax year will thus be $25,340 \times 105\%$, or $26,607. Each instalment will be one-third of this amount, or $8,869.

**Example 2:**
Assume the same facts as in Example 1, except that the company’s 20X1-X2 tax return was filed on 13 September 20X2 (after the due date for instalment 1 but before the due date for instalment 2) under an extension of time arrangement, and that the company’s RIT for 20X0-X1 was $22,150. For instalment 1 of 20X2-X3 provisional tax, the company’s provisional tax will be one-third of 110 per cent of 20X0-X1 RIT, or $22,150 \times 110\% / 3 = $8,122. By the time instalment 2 is due, the tax return has been filed so instalment 2 will be based on 105 per cent of 20X1-X2 RIT ($25,340 \times 105\% = $26,607). Two-thirds of $26,607 ($17,738) should have been paid by instalment 2. Since $8,122 was paid at instalment 1, this leaves $9,616 ($17,738 – $8,122)
to be paid at instalment 2. For instalment 3, provisional tax will simply be one-third of 105 per cent of 20X1-X2 RIT ($25,340 \times 105\% / 3 = $8,869).

**Example 3:**
A self-employed individual with a 30 June balance date had their 20X1-X2 income tax return prepared and filed by a tax agent on 16 January 20X2 under an extension of time arrangement. The provisional taxpayer’s 20X0-X1 RIT was $29,425. RIT for 20X1-X2 was $25,873. As at the due date for instalment 1 of 20X2-X3 provisional tax (28 November 20X2), the provisional taxpayer has not filed their tax return. The first instalment is therefore based on 110 per cent of RIT for the 20X0-X1 tax year ($29,425 \times 110\% = $32,367). Instalment 1 will be one-third of $32,367, or $10,789. By the time instalment 2 is due (28 March 20X3), the provisional taxpayer has filed their 20X1-X2 tax return. Instalment 2 will therefore be based on 105 per cent of 20X1-X2 RIT ($25,873 \times 105\% = $27,167). Two-thirds of $27,167 ($18,111) should have been paid by instalment 2. Since $10,789 was paid at instalment 1, this leaves $7,322 ($18,111 – $10,789) to be paid at instalment 2. Provisional tax payable at instalment 3 will be one-third of 105 per cent of 20X1-X2 RIT ($25,873 \times 105\% / 3 = $9,056).

**Example 4:**
A self-employed individual with a standard balance date had their 20X1-X2 income tax return prepared and filed by a tax agent on 26 September 20X2 under an extension of time arrangement. The provisional taxpayer’s 20X0-X1 RIT was $1,049. RIT for 20X1-X2 was $4,387. Because the provisional taxpayer’s 20X1-X2 tax return was filed between the due dates for the first and second instalments of 20X2-X3 provisional tax and RIT was less than $2,500, the provisional taxpayer is entitled to pay their provisional tax in two instalments, on 15 January 20X4 and 7 May 20X4 [see 1150.25]. The amount due on each instalment will be one-half of 105 per cent of 20X1-X2 RIT ($4,387 \times 105\% / 2 = $2,303).

The advantage for individuals in using the standard method is that if their RIT is less than $35,000 they do not have to pay use of money interest if their provisional tax is less than their final tax liability [see 1110.305]. For this reason, it is also sometimes referred to as the “safe harbour” method. Individuals who estimate their provisional tax, and provisional taxpayers that are not individuals, are subject to use of money interest regardless of the level of their RIT.

**Note:** A provisional taxpayer can change from the standard method to the estimation method at any time up to the third instalment date [see 1150.20]. For example, a provisional taxpayer could use the standard method for the first and second instalments, and then change to the estimation method for the third instalment. However, once a provisional taxpayer has elected to use the estimation method the provisional taxpayer cannot then change back to the standard method later in that tax year. If a provisional taxpayer adopts the estimation method the estimate can be revised at any subsequent instalment date. Provisional taxpayers affected by a “qualifying event” may re-estimate their provisional tax liability after their third instalment date [see 1150.22].

**1) Transitional provisional tax uplift rates**

Sections RZ 3 to RZ 5 provides transitional provisions for calculating provisional tax for the 2009-2010 and 2010-2011 tax years to take into account the reduced tax rate.

<table>
<thead>
<tr>
<th>Income year for provisional tax being calculated</th>
<th>Year of RIT amount used</th>
<th>Company/PIE</th>
<th>Individual</th>
<th>Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009-2010</td>
<td>2007-2008</td>
<td>95% of RIT</td>
<td>RIT - $1,460 + 5%</td>
<td>RIT + 5%</td>
</tr>
<tr>
<td>2009-2010</td>
<td>2008-2009</td>
<td>RIT (no adjustment)</td>
<td>RIT - $730</td>
<td>RIT (no adjustment)</td>
</tr>
<tr>
<td>2010-2011 and onward</td>
<td>2 years previous</td>
<td>RIT + 10%</td>
<td>RIT + 10%</td>
<td>RIT + 10%</td>
</tr>
<tr>
<td>2010-2011 and onward</td>
<td>Previous year</td>
<td>RIT + 5%</td>
<td>RIT + 5%</td>
<td>RIT + 5%</td>
</tr>
</tbody>
</table>

**1150.18 Residual income tax for the immediately preceding tax year**

[s RC 6]

The residual income tax (RIT) for the immediately preceding tax year is the basis for the calculation of provisional tax in the current year. The amount is dependent upon whether or not any RIT was calculated.
and/or assessed for the immediately preceding year. Therefore, the RIT for the immediately preceding tax year is whichever one of the following that is relevant in the circumstances

(a) It may be based upon the provisional taxpayer’s assessment for the preceding tax year unless the CIR has issued an assessment at least 30 days before the relevant instalment date.

Example:
Rangi’s 20X1-X2 tax return was filed on 30 April 20X2 and his tax assessment was issued on 3 August 20X2. The tax assessment shows a higher RIT than that shown on Rangi’s tax return. Because the tax assessment was issued less than 30 days before 28 August, Rangi’s 28 August 20X2 provisional tax instalment is calculated on the basis of the RIT shown in his tax return. Assuming Rangi accepts the CIR’s tax assessment, his second provisional tax instalment, due on 15 January 20X3, should be calculated on the basis of the RIT shown in the assessment, because 15 January is more than 30 days after the assessment was issued.

(b) It may be based upon the CIR’s assessment for that preceding tax year when the CIR has issued a notice of assessment for that year at least 30 days before the relevant instalment date.

Example:
Harry’s 20X1-X2 tax return was filed on 30 April 20X2 and his tax assessment was issued on 31 May 20X2. As the tax assessment was issued at least 30 days before his first instalment date of 28 August 20X2, his RIT is calculated on the basis of the CIR’s assessment.

(c) It may be based upon the CIR’s assessment for that preceding tax year, whenever that assessment is made if the provisional taxpayer has failed to furnish the return on or before the due date. It is also calculated in this way if the provisional taxpayer is not required to furnish a return of income for that year by the date of instalment F for the corresponding income year, and none of the other provisions in (a) to (d) applies to the provisional taxpayer.

(d) It may be based upon the RIT (if any) for the immediately preceding tax year, where the provisional taxpayer is not required to furnish a return of income for that preceding year, or the provisional taxpayer had RIT for the year before the immediately preceding tax year of less than $2,500 and is not required to furnish, and has not furnished, a return for that preceding year by the third instalment.

(1) Tax assessments after due date for payment
If the CIR makes an assessment after the due date for payment of the tax, and the taxpayer’s RIT for that year is increased accordingly, then for the purposes of the provisional tax rules the taxpayer’s RIT is treated as if it had not been increased by the new assessment. This enables the taxpayer’s provisional tax position to remain unchanged if late assessments or reassessments arise.

Example 3:
The CIR reassessed a provisional taxpayer’s 20X1-X2 tax return on 27 May 20X3. The provisional taxpayer’s 20X2-X3 provisional tax will be based on the RIT calculated in the CIR’s original assessment, because the reassessment occurred after all the due dates for payment of 20X2-X3 provisional tax.

(2) Residual income tax of amalgamated company
When an amalgamating company ceases to exist on amalgamation, for the purposes of determining the RIT of the amalgamated company, the RIT of the amalgamated company for the tax year preceding the year of amalgamation is deemed to be increased by the RIT of the amalgamating company for the corresponding year, had the amalgamating and amalgamated company always been one company. This applies only for instalments of provisional tax due after amalgamation.

(3) Tax rate changes
There are two new definitions to classify provisional taxpayers so that the correct provisional tax is calculated as from the 2008-2009 and later tax years as a result of reduced income tax rates. Provisional taxpayers are classified as either a “new personal tax rate person” or a “new tax rate person”; the former being provisional taxpayers subject to the personal tax rates and the latter being provisional taxpayers generally subject to the flat 30 per cent rate (previously 33 per cent).
A “new personal tax rate person” means a person whose basic rate of income tax is calculated under sch 1, Part A, cl 1 for the 2008-2009 income year or a later income year” [s YA 1]. From the 2008-2009 and later tax years, for the purposes of the provisional tax liability and GST ratio calculation from 1 October 2008 to the end of the 2008-2009 income year, the following amounts are reduced by $730:

(a) The person’s residual income tax for the preceding tax year;
(b) The person’s income tax assessment or residual income tax for the tax year before the preceding tax year or the transitional year, as applicable; or
(c) The person’s income tax assessment for the year that is two years before the preceding tax year or the transitional year, as applicable.

In the 2009-2010 tax year the calculated amount is reduced by $1,460.

A “new tax rate person” means a person who uses a 30 per cent basic tax rate for the 2008-2009 and later income years. For those provisional taxpayers using the five per cent standard uplift, the 2008-2009 provisional tax is 95 per cent of the 2007-2008 income year residual income tax, instead of being 105 per cent. For the 2009-2010 income year the provisional tax is 105 per cent of the residual income tax for the 2008-2009 income year. For those provisional taxpayers using the 10 per cent standard uplift, the 2008-2009 income year is 100 per cent of the residual income tax for the 2007-2008 income year instead of being 110 per cent. If the residual income tax for the 2007-2008 income year has not been calculated at the time to pay the provisional tax, then it is 100 per cent of the residual income tax for the 2006-2007 income year. After that, for the 2010-2011 income year the provisional tax for that year reverts to being 105 per cent of the residual income tax for the 2009-2010 income year or if that residual income tax has not been calculated, then it is 110 per cent of the residual income tax for the 2008-2009 income year.

Similar adjustments are available if the company was to be paying its provisional tax instalments under the new GST ratio method.

1150.20 Estimation method [s RC 7]

If the provisional taxpayer furnishes an estimate of residual income tax (RIT), and the CIR has not determined the provisional tax payable under s 119 of the TAA [see 1150.65], the amount of provisional tax payable is simply the amount estimated on or most recently before the instalment date.

Example 1:
Henrietta, who has a standard balance date, estimates her provisional tax to be $8,400. On her first instalment date she will pay $2,800 provisional tax (⅓ of $8,400).

The advantage in estimating provisional tax is that taxpayers can avoid paying too much provisional tax, for example when their income is less than in the previous year. Provisional taxpayers who are not natural persons, or who are natural persons who have RIT over $35,000, can minimise their liability to use of money interest by accurately estimating, or alternatively overestimating, their provisional tax [see 1110.305].

However, natural person provisional taxpayers with RIT under $35,000 may prefer not to use the estimation method as they will be liable for use of money interest on any shortfall. Provisional taxpayers who estimate may also be liable for shortfall penalties if they do not take reasonable care in calculating their estimation [see 1110.90].

When provisional taxpayers estimate provisional tax, the following rules apply:

(a) Any provisional taxpayer may, on or before the day on which an instalment of provisional tax becomes due and payable, make a fair and reasonable estimate or revised estimate of RIT for the tax year and furnish to the CIR a statement showing the amount so estimated; and

(b) Provisional taxpayers who furnish an estimate or revised estimate must take reasonable care in making that estimate, and if an estimate ceases to be fair and reasonable they must make a revised estimate on or before the next instalment date.
Example 2:
Action Appliances Ltd made a “fair and reasonable” estimate of their provisional tax of $21,000, and paid $7,000 provisional tax on their first instalment date. Between the first and second instalment dates Action Appliances Ltd got a very large contract which meant that their $21,000 estimate of provisional tax was no longer reasonable. They are required to make a revised estimate of provisional tax on or before their second instalment date.

If a provisional taxpayer makes an estimate which exceeds the actual amount of provisional tax payable, the provisional taxpayer is deemed to have taken reasonable care.

Example 3:
Jake estimates his provisional tax to be $53,000. His RIT was actually $45,000. As Jake’s estimate exceeds his actual liability he is deemed to have taken reasonable care. However, if Jake had estimated his provisional tax to be $45,000, when his actual liability was $53,000 it would be open for the CIR to consider whether Jake had shown a lack of reasonable care in making his estimation, and he could be liable for a shortfall penalty [see 1110.90].

(1) Changing calculation method from GST ratio
If, under s RC 18(5), a person using the GST ratio method changes the way provisional tax is determined after the date of an instalment, the residual income tax must be estimated for the corresponding income year, and provisional tax shall be paid on whichever of the following instalment dates for the income year occur after 30 days from their last ratio instalment date:

(a) C and F for changes to a six-monthly GST taxable period;
(b) B, D, and F for other changes [see 1150.40].

1150.21 GST ratio method [ss RC 8, RC 15, RC 16, RC 17, RC 18, RC 19, RZ 4]
Provisional taxpayers who are liable to pay provisional tax and meet the requirements of s RC 16 and not excluded by s RC 17 may choose to use a GST ratio to determine the amount of provisional tax payable for a tax year [s RC 8].

They must inform the CIR of this before the start of the income year [s RC 15]. The election to use a GST ratio applies for the tax year for which the election is made and for later tax years, unless the calculation method is changed under s RC 18. They are eligible to use the GST ratio method only if they meet all the following requirements for the preceding year and the current year.

In the preceding tax year and the corresponding income year:

(a) Their residual income tax shall be more than $2,500 and not more than $150,000;
(b) They shall be GST-registered for the whole income year, and provided a GST return for a taxable activity that did not begin operations in that tax year; and
(c) The ratio of residual income tax to total taxable supplies expressed as a percentage, shall be between zero per cent and 100 per cent. A reference to a preceding tax year includes a reference to a tax year earlier than the preceding tax year if that earlier tax year is used for the purposes of calculating a GST ratio.

In the current year they must be liable to file a GST return for either a two-month or a one-month period [s RC 16].

The GST ratio is the percentage figure that is obtained by dividing the residual income tax for the preceding tax year by the total taxable supplies for the corresponding income year. The amount of residual income tax and the amount of total taxable supplies are called base amounts. If a base amount for the preceding tax year or corresponding income year is not known, the GST ratio is the percentage based on the assessment for the tax year and corresponding income year that are just before the preceding tax year and corresponding income year.

The CIR, and not the provisional taxpayer, calculates the GST ratio, and shows the amount on the provisional taxpayer’s preprinted GST return form. It can also be advised to the provisional taxpayer in writing, by telephone or some other means. The CIR shall adjust the GST ratio if a base amount is revised. Various reasons may require the GST ratio to be adjusted such as the issue of an assessment or an amended assessment.
for the preceding tax year, a change in the value of the total taxable supplies for the corresponding income year, or the disposal of an asset to which s RC 19 applies. When an adjustment is done to the GST ratio then the CIR must inform the provisional taxpayer. The new ratio applies to any relevant instalment dates that occur 30 days after the date on which the provisional taxpayer is informed.

If a provisional taxpayer has paid instalments of provisional tax in a transitional year [see 1150.80] for the tax year that follows the transitional year then the transitional year is ignored when determining the residual income tax or total taxable supplies. The residual income tax and total taxable supplies is then based on the tax year preceding the transitional year.

The total taxable supplies amount in the calculation is the GST inclusive amount of the total value for the period [s RC 8].

Provisional taxpayers must stop using a GST ratio for a tax year if:

(a) Their GST registration ends in the tax year; or
(b) They no longer qualify as a result of an amended assessment of their income tax liability or their GST liability for the preceding tax year; or
(c) They no longer qualify as a result of a change in their taxable period.

They must also not use, or must stop using, a GST ratio for a tax year if they are liable to provide a GST return for a period in their corresponding income year and do not file the return within 60 days after the due date for the return. They must then pay the provisional tax instalments required under the estimation method [s RC 18].

However, they may continue to use a GST ratio for an instalment period if they apply in writing or by telephone to the CIR who considers that the failure to file the return is caused by an event or circumstance beyond the person’s control; and it provides reasonable justification or excuse for the failure; and the provisional taxpayer has remedied the failure as soon as practicable. The CIR must notify this reinstatement to the provisional taxpayer. The CIR is required to use the same approach that would be used to justify the remission of a penalty under s 183A of the TAA [see 1110.90]. Such notice does not automatically refer to a later default unless the failure is anticipated and referred to in the notice and the instalment period begins on or after the due date of the return [s RC 17].

After having chosen to use a GST ratio for a tax year, a provisional taxpayer may either choose another way to calculate provisional tax or be required to stop using a GST ratio for the corresponding income year. A provisional taxpayer who chooses another method must inform the CIR of the decision either in writing or by telephone.

The date on which the person stops using a GST ratio is (as applicable) the:

(a) Date the GST registration ends;
(b) Date of the amended assessment of the income tax liability or GST liability for the preceding tax year;
(c) Effective date of a change in taxable period; or
(d) Last day of the period in which a GST return is liable to be provided.

The date on which the change applies may be a future date agreed between the person and the CIR.

If the GST ratio method changes before the date of instalment A, then the provisional tax payable is calculated under s RC 5(2), (3) or (5), and the provisional taxpayer is treated as never having chosen to use the GST ratio method. If the GST ratio method is changed after an instalment date, then the amount of provisional tax payable on instalments for the remainder of the income year is calculated under s RC 5(5) using the estimation method. The estimate may be advised to Inland Revenue in writing or by telephone.

When a provisional taxpayer using the GST ratio method disposes of an asset that is not revenue account property, and the value of the asset is not less than the greater of either $1,000 or five per cent of the total taxable supplies of the business for the previous 12 months then an adjustment to GST ratio for current and next income year is available.
The provisional taxpayer may choose to take the disposal of the asset into account in adjusting the taxable supplies for the relevant taxable period and income year, by subtracting the value, including GST, of the asset from:

(a) The total taxable supplies for a taxable period in proportion to the output tax which is attributed to that taxable period for the supply of the asset; or

(b) The base amount of total taxable supplies for the corresponding income year in proportion to the output tax which is attributed to a taxable period in that income year for the supply of the asset.

The provisional taxpayer must also inform the CIR of both the disposal of the asset and the value of its supply, and may do this either in writing or by telephone.

1150.22 **Provisional taxpayers affected by natural disasters** [s RC 36]

Provisional taxpayers who are liable to pay provisional tax and are significantly affected by a self-assessed adverse event or qualifying event (see below), may estimate or re-estimate their residual income tax (RIT) liability after the normal due date for making the estimate. This overrides s RC 7 [see 1150.20]. The CIR may accept the estimate or revised estimate if all the following requirements are met:

(a) The business is significantly affected by the self-assessed adverse event or qualifying event;

(b) It is not reasonable to require the person to provide under s RC 7 an estimate or revised estimate of residual income tax payable by them for the tax year;

(c) The basis on which the person has chosen to pay provisional tax is now inappropriate; and

(d) The person asks to revise their estimate as soon as practicable.

If the revised estimate is accepted it is treated as the estimate applying on the date of instalment F [see 1150.40].

A “self-assessed adverse event” materially affects a farming, agricultural or fishing business and is either a drought, fire, flood, or some other natural event, or disease or sickness of livestock. It shall be described to the CIR by the provisional taxpayer in a statutory declaration [s YA 1].

A “qualifying event” means:

(a) The extreme climatic conditions that occurred during February 2004 in New Zealand;

(b) The storm event that occurred during July 2004 in the Bay of Plenty area;

(c) Any naturally-occurring event that occurs after July 2004:

(i) For which a state of emergency is declared; and

(ii) That is declared by Order in Council to be a qualifying event [s YA 1].

1150.25 **Number of provisional tax instalments** [ss RA 4, RC 9, RC 13]

Generally, for a provisional taxpayer liable to pay provisional tax using the standard and estimation methods, the amount of the provisional tax liability is spread evenly over the applicable number of instalments, so that equal amounts are paid on each instalment date. If the full amount is not divisible into exactly equal instalments, the final instalment carries the difference.

A provisional taxpayer who is not GST-registered, as well as a provisional taxpayer who is GST registered (paying GST monthly or two-monthly) but who is not on the GST ratio method will pay provisional tax in three instalments. A provisional taxpayer who is GST-registered (paying GST six-monthly) will pay provisional tax in two instalments.

A provisional taxpayer who is GST registered and uses the GST ratio method will pay provisional tax in six instalments, whether or not GST is paid monthly or two-monthly [s RC 9]. The dates for payment of GST and provisional tax are the same [see 1150.40].

Table R1 gives a summary of instalment dates under the various calculation methods for provisional tax.
Provisional and Terminal Tax

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Categories: exceptional

- Persons with initial provisional tax liability
  - RC 6 or RC 7
  - RC 9(9), RC 13(3), RC 14(2)
  - D and F, or F as required
  - RC 10 [RC 13(4)], RC 10 [RC14(3)]
  - 120KC

- Transitional years
  - RC 20
  - RC 22 [RC 9(11)]
  - B, D, F, or C, F as required
  - RC 22 to RC 24
  - 120KC

- Changing taxable period, or starting and stopping GST registration
  - RC 27, 15C, 15E GSTA 1985
  - RC 27 [RC 9(8)]
  - B, D, F, or C, F as required
  - RC 26, RC27
  - 120KD

- Changing calculation method
  - RC 18
  - RC 7(6), RC 9(7)
  - B, D, F, or C, F as required
  - RC 18
  - 120KE(5)-(7)

- Voluntary payments
  - RC 12
  - 120E

Example 1:
A provisional taxpayer who pays GST either monthly or two-monthly using either the standard uplift or the estimation method has three instalments of provisional tax and the instalment dates are given as codes in the form of B, D, F. The codes B, D, F refer to the columns shown in sch 3 [see 1150.40]. Therefore, under sch 3 this provisional taxpayer with a 31 March balance date will have provisional tax payable in three instalments on 28 August (first instalment), 15 January (second instalment) and 7 May (third instalment). If this provisional taxpayer had a 30 June balance date then provisional tax is payable in three instalments on 28 November (first instalment), 28 March (second instalment) and 28 July (third instalment).

Example 2:
A provisional taxpayer who pays GST six-monthly using either the standard uplift or the estimation method has two instalments of provisional tax and the instalment dates are given as codes C and F. The codes C and F refer to the columns shown in sch 3 [see 1150.40]. Therefore, under sch 3 this provisional taxpayer with a 31 March balance date will have provisional tax payable in two instalments on 28 October (first instalment) and 7 May (second instalment). If this provisional taxpayer had a 30 June balance date then provisional tax is payable in two instalments on 28 January (first instalment) and 28 July (second instalment).
Example 3:
A provisional taxpayer using the GST ration method and paying GST either monthly or two-monthly has six instalments of provisional tax and the instalment dates are given as codes A to F. The codes A to F refer to the columns shown in sch 3 [see 1150.40]. Therefore, under sch 3 this provisional taxpayer with a 31 March balance date will have provisional tax payable in six instalments on 28 June (first instalment), 28 August (second instalment), 28 October (third instalment), 15 January (fourth instalment) 28 February (fifth instalment) and 7 May (sixth instalment).

Note: The final instalment will often fall after 31 March which can create difficulties in the imputation system for provisional taxpayers which are companies, as the credits to the ICA only arise for tax payments on the date when the payment is made. This may result in the tax payable for a particular tax year not being sufficiently aligned with income. If foreseen in such cases, the matter can be rectified by paying the final instalment of provisional on or before 31 March for the corresponding tax year.

A transitional year refers to the situation when a provisional tax payer has a tax year that is not equal period of 12 months. In such cases refer to 1150.80 to 1150.83 for the dates, instalment amounts and relevance to subsequent years.

In the following examples, it is assumed that the provisional taxpayers have a 31 March balance date.

Provisional tax is payable in two instalments by:

(a) A person with an initial provisional tax liability (a new provisional taxpayer) [see 1150.10], whose first business day falls either after, or less than 30 days before, the first instalment date and more than 30 days before the second instalment date [s RC 13].

Example 1:
Innovation Ltd, a new provisional taxpayer, commences business on 1 August 20X1. The company will have to pay provisional tax in two instalments, because 1 August 20X1 is after the first instalment date (7 July 20X1) and more than 30 days before the second instalment date (7 November 20X1). If Innovation Ltd were to commence business on 1 July 20X1 it would still only have to pay provisional tax in two instalments because 1 July 20X1 is less than 30 days before the first instalment date (7 July 20X1).

Note: New business taxpayers [see 1150.10], are generally not required to pay provisional tax in their first year of business, as it is likely that their RIT for the previous year was less than $2,500 [see 1150.45]. However, they could still be liable for use of money interest back to the first provisional tax instalment date, if their RIT exceeds $35,000 and they have a provisional tax shortfall. The “new provisional taxpayer” rules may limit the exposure to use of money interest in this regard as they limit the number of provisional tax instalments.

(b) A provisional taxpayer whose tax return for the previous tax year was filed after the first instalment date and on or before the second instalment date, where the provisional taxpayer was granted an extension of time under s 37 of the TAA for filing the return, and the provisional taxpayer’s RIT for the year before the previous tax year was less than $2,500 [s RC 13].

Example 2:
Marie’s 20X1-X2 tax return is filed on 12 August 20X2 by her tax agent under an extension of time arrangement. Marie’s 20X1-X2 RIT is $5,000 and her 20X0-X1 RIT was $150. Marie can pay her 20X2-X3 provisional tax in two instalments because her tax return was filed after the first instalment date.

The foregoing provisions do not apply to a provisional taxpayer when GST is payable on a six-monthly basis, although they may qualify to pay provisional tax in one instalment (see below).

Provisional tax is payable in one instalment by:

(a) A new provisional taxpayer whose first business day falls either after, or less than 30 days before, the second instalment date [s RC 14].

Example 3:
Innovation Ltd, a new provisional taxpayer, commences business on 20 January 20X2. The company will have to pay one provisional tax instalment for the 20X1-X2 tax year, because 1 January 20X2 is after the second instalment date of 15 January 20X1. If Innovation Ltd were to commence business on 1 November 20X1 they would still only have to pay provisional tax in one instalment because 7 January 20X1 is less than 30 days before the second instalment date of 15 January 20X1.
(b) A provisional taxpayer whose tax return for the previous tax year was filed after the second instalment date, if the provisional taxpayer was granted an extension of time under s 37 of the TAA for filing the return and the taxpayer’s RIT for the year before the previous tax year was less than $2,500 [s RC 14].

**Example 4:**
Darryn’s 20X2-X3 tax return is filed on 23 February 20X4 by his tax agent under an extension of time arrangement. Darryn’s 20X2-X3 RIT is $5,000 and his 20X1-X2 RIT was $150. Darryn can pay his 20X3-X4 provisional tax in one instalment because his tax return was filed after the second instalment date.

(c) Provisional taxpayers who pay GST on a six-monthly basis may pay one instalment if their first business day occurs within 30 days before the first instalment (instalment C) and before the end of the corresponding income year. They also qualify to pay one instalment where they have been granted an extension of time under s 37 of the TAA for filing the return, and their RIT for the previous tax year was less than $2,500 [s RC 14].

If a natural person uses the standard (uplift) method of calculating provisional tax and their RIT is under $50,000 they are not subject to use of money interest [see 1110.305]. Tax agents may wish to delay filing tax returns for natural persons paying provisional tax for the first time until after the second instalment date, because then their provisional tax can all be paid on the third instalment date. Similarly, there are timing advantages in delaying the filing of returns for natural persons when RIT has increased considerably from the previous year, provided their RIT is under $50,000. The same advantages do not apply to non-natural provisional taxpayers, nor to natural provisional taxpayers who estimate their provisional tax or have RIT over $50,000, because these provisional taxpayers are subject to use of money interest from their first instalment date.

The “instalment date” is specified in sch 3 [see 1150.40], as a month in which payment of an instalment of provisional tax is payable.

“First business day”, for a non-individual, means the first day in a tax year on which gross income is derived or expenditure is incurred as a result of carrying on a taxable activity. “Taxable activity” has the same meaning as in the GSTA 1985.

“First business day”, for an individual, means the day following the last day in a tax year on which the taxpayer derives employment income.

If a provisional taxpayer has a change of balance date, provisional tax is payable in the number of instalments specified in the second column of Part B of sch 13 [see 1150.80].

**1150.30 Amount of provisional tax instalments** [ss RC 10, RC 11]

The amount of provisional tax payable on an instalment date is calculated using the total provisional tax payable [see 1150.12 to 1150.21], and the number of instalments determined [see 1150.25].

The amount of an instalment of provisional tax for a provisional taxpayer who uses either the stand uplift or estimation method (but not the GST ratio method) is calculated using the following formula:

\[
\text{residual income tax} \times \frac{\text{instalment number}}{\text{total instalments}} - \text{provisional tax}
\]

Where:

“Residual income tax” is the residual income tax (as applicable):

(a) For the preceding tax year, uplifted by five per cent (modified as applicable by s RZ 5 (Calculating amounts under standard method: 2008-2009 and 2009-2010 income years);

(a) For the tax year before the preceding tax year, uplifted by 10 per cent (modified as applicable by s RZ 5); or

(a) The amount estimated by them;

“Instalment number” is the number of the instalment for the tax year, whether first, second, or third;

“Total instalments” is the total number of instalments for the tax year;
“Provisional tax” is the amount provisional tax liabilities for the tax year to date [s RC 10].

When a provisional taxpayer is required to pay provisional tax for a tax year in three instalments, those instalments shall be due and payable on the first instalment date, second instalment date, and third instalment date respectively, and the amount of each instalment shall be calculated as follows:

(a) For the first instalment, one-third of the provisional tax payable for that tax year, as that provisional tax is determined at the time of the first instalment date;

(b) For the second instalment, the balance remaining after deducting from two-thirds of the provisional tax payable for that tax year (as that provisional tax is determined at the time of the second instalment date) the amount of provisional tax previously due and payable for that tax year; and

(c) For the third instalment, the balance remaining after deducting from the provisional tax payable for that tax year (as that provisional tax is determined at the time of the third instalment date) the amount of provisional tax previously due and payable for that tax year.

Example 1:
Wendy’s 20X1-X2 tax return is filed on 1 May 20X2. Wendy has a 31 March 20X2 balance date. Her 20X1-X2 RIT was $14,500. Wendy wants to calculate her 20X2-X3 provisional tax using the standard method. Her three instalments of provisional tax will each be $5,075 (1/3 of $14,500 × 105%).

Example 2:
Jason’s 20X1-X2 tax return is filed under an extension of time arrangement on 1 October 20X2. Jason has a 31 March 20X2 balance date, and his 20X1-X2 RIT was $14,500 and his 20X0-X1 RIT was $12,000. Jason wants to calculate his 20X2-X3 provisional tax using the standard method. On 7 July 20X2 he will need to pay $4,400 (1/3 of $12,000 × 110%). On 7 November 20X2 he will need to pay $5,750 (2/3 of $14,500 × 105% less the $4,400 already paid). On 7 March 20X3 he will need to pay $5,075 ($14,500 × 105% less the $4,400 and $5,750 already paid).

When a provisional taxpayer is entitled to pay provisional tax for an income year in two instalments, the two instalments are due and payable on the second instalment date and the third instalment date respectively, and the amount of each instalment is calculated as follows:

(a) For the first instalment, one half of the provisional tax payable for that income year, as calculated at the time of the second instalment date; and

(b) For the second instalment, the balance remaining after deducting from the provisional tax payable for that income year (as that provisional tax is determined at the time of the third instalment date) the amount of provisional tax previously due and payable for that tax year.

Example 3:
Sharon is entitled to pay her provisional tax in two instalments. Her provisional tax payable is $20,200. She will have to pay two equal instalments of $10,100.

When a provisional taxpayer is entitled to pay provisional tax in one instalment, that instalment is due and payable on the third instalment date, and the amount of that instalment is the provisional tax payable for that tax year, as calculated at the time of the third instalment date.

Example 4:
Tangesh is entitled to pay his provisional tax in one instalment. His provisional tax payable is $3,800. He will have to pay all of the $3,800 on his third instalment date.

The amount of an instalment of provisional tax for a provisional taxpayer who uses the GST ratio method is calculated using the following formula:

\[ \text{GST ratio for tax year} \times \text{total taxable supplies} \]

Where:

“GST ratio” is calculated by the CIR [see 1150.21];

“Total taxable supplies” is the amount total taxable supplies in the taxable period that matches the instalment period.
Where GST is paid on a one-month cycle then the GST ratio is applied to the sum of their taxable supplies in the current taxable period and the preceding taxable period, that is, the taxable supplies in the two-month period matching the instalment period [s RC 11]. The GST ratio method is modified for the 2008-2009 and 2009-2010 income years [s RZ 4].

1150.33 Provisional tax and the attribution rules [s RC 34]

If a provisional taxpayer (“B”) has had income from personal services attributed to them from an associated provisional taxpayer (“C”) [ss GB 27 to GB 29], any overpayment of provisional tax by either B or C may be allocated to the other person. See 740.30 to 740.40 for an explanation of the attribution rules.

The amount of overpaid provisional tax that may be allocated in this way is limited to the amount by which the recipient’s residual income tax (RIT) exceeds their provisional tax paid.

Example:
Jeremy, a personal services provider, has had $50,000 attributed to him from an associated company (Huggles Ltd). His total income for the year, including the amount attributed, is $80,000. Huggles Ltd has paid provisional tax of $33,000 for the year. Its RIT, following the allocation, is $15,000. Jeremy has paid provisional tax of $10,000 for the year. His RIT is $22,500. The overpayment of provisional tax by Huggles Ltd ($18,000) is available to be allocated to Jeremy but the amount that may be allocated is limited to Jeremy’s underpayment of provisional tax ($12,500).

An allocation cannot be made until the excess provisional tax is actually paid or the first instalment of provisional tax for the year (for the person making the allocation) is due, whichever is the later.

The allocation is made by giving written notice to the CIR. Notice must be given on or before the due date for the person receiving the allocation to file their tax return for the year [see 1270.60-61]. The notice must contain the following information:
(a) The name of the person to whom the excess provisional tax is being allocated and the amount allocated; and
(b) The date on which the allocation is made.

The provisional tax allocated is treated as provisional tax paid by the recipient and not by the donor [see TIB vol 12:12 (December 2000) at 54-57].

1150.35 Offset of further income tax [s RC 35]

Further income tax is an amount of tax that is imposed if the provisional taxpayer’s imputation credit account (ICA) has a debit balance at 31 March or when the company ceases for any reason to be an ICA company [see 670.95]. When a company has paid further income tax, the payment of any instalment of provisional tax for which the company becomes liable after the date of payment of the further income tax is satisfied by the amount of the further income tax, so far as that amount extends.

The CIR credits the amount of the further income tax in payment successively of:
(a) The instalment of provisional tax that first falls due and payable after the date of payment of the further income tax; and
(b) Instalments subsequent to that instalment, in the order in which they fall due and payable, so far as the amount of the further income tax extends.

The amount is deemed to have been paid on the date on which the instalment so credited was due and payable.

Any imputation penalty tax imposed on further income tax cannot be used to satisfy a company’s provisional tax liability.

Example:
Discovery Ltd had a $5,000 debit balance in their ICA at 31 March 20X1. They paid the $5,000 further income tax required, together with the $500 imputation penalty tax, on 20 June 20X1. Their first 20X1-X2 provisional tax instalment of $8,000 is due on 28 August 20X1. They can offset the $5,000 further income tax paid against the $8,000 first instalment and are, therefore, only required to pay $3,000 provisional tax on 28 August 20X2.

1150.40 Dates of payment [sch 3]

The number of instalments and the amount payable on each instalment is discussed in 1150.25 and 1150.30. Instalments of provisional and terminal tax are due in the months shown in the following table (from sch 3). Provisional tax is due on the 28th day of the month specified, except in January when payment is due.
on the 15th of the month and in May when the payment is due on the 7 May. The term “balance date” means
the annual balance date of a provisional taxpayer’s accounts for the period for which the provisional taxpayer
is required to file a tax return. The first and second provisional tax instalments are due in the months preceding
the month of balance date. The third provisional tax instalment is due in the same month as the month of
balance date. Terminal tax [see 1150.70] under Columns G and H is due in the month, shown in the table,
which follows the balance date.

<table>
<thead>
<tr>
<th>Month of balance date</th>
<th>A</th>
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<td>28 Oct</td>
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1150.45 Taxpayers not required to pay provisional tax [s RC 3]

No taxpayer, including a taxpayer who comes within the definition of a provisional taxpayer, is obliged to
pay provisional tax for any tax year if their RIT for the preceding year did not exceed $2,500. However, a
provisional taxpayer (RIT in current year exceeds $2,500) who is not required to pay provisional tax because
their RIT for the previous year did not exceed $2,500, needs to be aware of the use of money interest provisions
[see 1110.305], in deciding whether to pay provisional tax.

Example 1:
Ronny Mac Ltd has 20X1-X2 RIT of $23,000, and 20X0-X1 RIT of $2,000. Ronny Mac Ltd is not required to pay 20X2-X3
provisional tax, because its 20X0-X1 RIT was less than $2,500. However, Ronny Mac Ltd will be subject to use of money interest
from the first 20X1-X2 provisional instalment date (7 July 20X2).

Example 2:
Ronny Mac, an individual, has 20X1-X2 RIT of $23,000, and 20X0-X1 RIT of $2,000. He is not required to pay 20X2-X3
provisional tax, because his 20X0-X1 RIT was less than $2,500. Provided he does not estimate his 20X1-X2 provisional tax he
will not be subject to use of money interest.

1150.50 Election to be a provisional taxpayer [s RC 4]

Normally a taxpayer is not a provisional taxpayer in an income year unless their RIT for the tax year is $2,500
or more. However, a taxpayer may elect to be a provisional taxpayer in a tax year if at least $2,500 has been
paid as provisional tax by the third instalment date (instalment F) by the final instalment date if the taxpayer
is in a transitional year. This applies if the taxpayer had, on the day the first payment of provisional tax was
made for that tax year, a reasonable expectation of being a provisional taxpayer. The election is made when
first furnishing a tax return for the tax year to which the election relates.

This provision enables taxpayers who have paid provisional tax and later find that this was not necessary to
receive use of money interest on the overpayment, which would run from the day after the payment. These
provisions apply to taxpayers who chooses to pay provisional tax [s RC 2], except for those who are not
required to pay provisional tax under s RC 3(2)(a) to (d) [see definition of “provisional taxpayer” in
1150.10. Taxpayers who meet the above criteria may elect to be provisional taxpayers whether they have standard or non-standard balance dates.

1150.55 **Voluntary payments of provisional tax** [s RC 12]

Taxpayers can make voluntary payments of provisional tax should they wish. A taxpayer may at any time make voluntary payments of provisional tax, being either:

(a) For the income tax liability in a tax year when the taxpayer does not have a provisional tax liability;
(b) For an amount which is more than the provisional tax liability for that tax year; or
(c) For an amount which is more than the income tax liability for that tax year.

One of the main reasons for making voluntary payments is to reduce exposure to use of money interest charges [see 1110.305] on any known tax shortfalls. Another reason, for individuals whose RIT is under $35,000, is to reduce the taxpayer’s terminal tax liability without making a formal estimation which would bring the taxpayer under the use of money provisions.

1150.57 **Early-payment discount for new small businesses** [ss RC 37, RC 38, RC 39, RC 40]

Self-employed individuals and partners in partnerships are entitled to a discount of 6.7 per cent of the amount of income tax they pay in any income before the income year they first pay provisional tax. The aim of the discount is to encourage individuals who begin receiving self-employed or partnership income to pay tax voluntarily before they are required to pay provisional tax. New business taxpayers are not required to pay provisional tax until the income year following the income year in which their residual income tax (RIT) first exceeds $2,500 [see 1150.05]. This means that they have two years tax to pay in the year in which they first pay provisional tax (the previous year’s terminal tax and second the current year’s provisional tax). By encouraging new business owners to pay income tax early, the discount helps relieve the financial strain in the in year in which provisional tax is first paid.

The early-payment discount applies to tax years commencing from 1 April 2005. The discount applies to taxpayers (referred to as a small-business person) who:

(a) Conducts a business on his or her own account, acting alone or as a partner in a partnership;
(b) Does not use a company or a trust in the conduct of the business; and
(c) Derives income that is mainly from the business, and does not consist of interest, dividends, royalties, rent, or beneficiary income [s RC 40].

A small-business taxpayer qualifies for the early-payment discount for a tax year if the small-business taxpayer:

(a) Is not required to pay provisional tax;
(b) Makes income tax payments on or before balance date;
(c) Throughout the period from balance date to the terminal tax date, has a credit balance with Inland Revenue at least equal to the lesser of the amount of tax paid on or before balance date and the amount of terminal tax payable (before deducting tax paid); and
(d) Has not previously been required to pay provisional tax and has not previously received an early-payment discount.

A small-business taxpayer can receive the early-payment discount more than once, but only if four tax years have elapsed since the last tax year for which the early-payment discount was received and during those four years the small-business taxpayer derived no income from a business.

Even if a small-business taxpayer has previously been required to pay provisional tax, the taxpayer will still qualify for the early-payment discount if they have not derived any business income during the four tax years since the last tax year for which the taxpayer was required to pay provisional tax. This enables individuals who have ceased to carry on a business to claim the discount when they set up a new business in the future, subject to the four-year restriction [s RC 37].
A small-business person who meets the criteria applies for the early-payment discount in their income tax return. The amount of the discount is 6.7 per cent of the lesser of the following amounts:

(a) The amount of income tax the small-business taxpayer has paid on or before balance date;
(b) 105 per cent of the small-business taxpayer’s residual income tax for the tax year.

The discount is credited to the small-business taxpayer’s income tax account and is treated as being a payment made by the small-business taxpayer on the day after the last day of the tax year [s RC 38].

The discount will be credited to the taxpayer’s income tax account only if the return in which the application is made is filed by the due date specified in s 37(5) of the TAA [see 1270.60]. For examples see TIB vol 17:1 (February 2005) at 50-53.

**1150.60 Refund of overpaid provisional tax** [TAA, s 173]

Where the amount of provisional tax payable by a provisional taxpayer for a tax year is reduced by the provisional taxpayer (eg, as a result of re-estimating RIT), or by the CIR under s 119(2) of the TAA, and as a result the provisional taxpayer has overpaid their provisional tax, the provisional taxpayer may make written application for a refund of the over-payment. In this situation, the CIR will first apply the excess against any unpaid income tax due by the provisional taxpayer for any earlier tax year, in accordance with the provisional taxpayer’s or their agent’s request under s 173T of the TAA [see 1215.48], and any of the excess remaining will be refunded to the provisional taxpayer.

Where a provisional taxpayer’s first or second instalments of provisional tax for a tax year are based on 110 per cent of the RIT for the year before the immediately preceding tax year [see 1150.15], but the provisional taxpayer’s RIT for the immediately preceding tax year is subsequently assessed as not exceeding $2,500, the taxpayer may make written application for a refund of the provisional tax paid on either or both of those two instalments. The CIR will first apply the tax paid against any unpaid income tax due by the provisional taxpayer for any earlier tax year, in accordance with the provisional taxpayer’s or their agent’s request under s 173T of the TAA, and any of the excess remaining will be refunded to the provisional taxpayer.

Where any excess provisional tax paid has been refunded or credited as per the above rules, any subsequent instalments of provisional tax payable are calculated as if the total of the instalments previously payable were reduced by the excess, and the amount of the excess refunded or credited is (as from the date of the refund or credit) deemed not to have been paid for that tax year.

**1150.62 Transfer of excess provisional tax** [TAA, Part 10B]

When a provisional taxpayer overpays their provisional tax for the year the excess, instead of being refunded, can be transferred to another tax period, tax type or provisional taxpayer. Within certain limits, the provisional taxpayer can elect the date of the transfer and so minimise exposure to UOMI. There are also restrictions on the amount of provisional tax that can be transferred as at a particular date [see 1215.30 and 1215.40 to 1215.44].

**1150.65 Determination of provisional tax by CIR** [TAA, s 119]

When the CIR makes a determination of the total provisional tax payable by a provisional taxpayer, the following rules apply. Any provisional tax determined by the CIR shall be open to objection or challenge. The CIR may, at any time, determine the amount that, in its opinion, ought to be the provisional tax payable by a person for a tax year (being an amount greater than what would otherwise be payable) where:

(a) The person defaults in furnishing the income tax return for the immediately preceding tax year;
(b) The CIR is not satisfied with a return made by the person for any of the two immediately preceding tax years;
(c) The CIR has reason to believe that the person is a provisional taxpayer, although the person has not furnished a return; or
(d) The CIR considers that an estimate of RIT furnished by the person was not fair and reasonable, either at the time the estimate was furnished or on any instalment date.
Provisional and Terminal Tax

The CIR may, at any time, determine the amount that, in its opinion, ought to be the provisional tax payable by a provisional taxpayer for a tax year (being an amount greater or lesser than what would otherwise be payable) where the CIR considers that the provisional tax that would be payable by the person is excessive. The amount of provisional tax determined by the CIR cannot exceed the amount of provisional tax that would be payable if the provisional taxpayer had not made an estimate, that is, it cannot exceed the amount calculated under the standard method.

Where the CIR determines an amount, the provisional taxpayer must be advised of the determination in writing and, where the provisional tax payable is increased:

(a) The consequent shortfall shall be due and payable on the day specified in the notice, being a day not less than 30 days after the issuing of the notice; or

(b) If the notice specifies that an estimate furnished by the provisional taxpayer was not fair and reasonable, the consequent shortfall for any instalment is generally due on that instalment date, even if that date has already passed.

1150.68 Allowance for provisional tax paid by agent [ss LA 6, LB 2]

Where an agent is liable to pay provisional tax on behalf of the agent’s principal, any amount paid by the agent is credited to the principal’s account on the date on which that payment is made.

1150.70 Terminal tax [ss BC 8, RA 3, RA 13, RB 1]

A taxpayer’s terminal tax is the balance of tax they have to pay for a tax year, after allowing for tax credits. That is, it is the amount by which their tax liability for the year exceeds their tax credits for the year, including any provisional tax payments [see 230.60].

Example 1:
Jane’s income tax liability is $15,000. Her tax credits, for rebates and PAYE totalled $14,700. Her terminal tax is $300 ($15,000 – $14,700).

Terminal tax, for both provisional taxpayers and non-provisional taxpayers, is due and payable on the seventh day of the month specified in sch 13 as being the month for payment of terminal tax [see 1150.40], unless the terminal tax is due in January, in which case it is due on 15 January.

Example 2:
Cool Water Ltd’s 20X1-X2 RIT was $17,000. They paid $16,000 provisional tax. Terminal tax of $1,000 is due by 7 February 20X3.

Non-resident companies with no fixed establishment in New Zealand must pay their terminal tax for a tax year by 7 February of the year following the tax year, unless the company’s return was linked to a tax agent, in which case terminal tax must be paid by 7 April.

(1) Returns prepared or filed by tax agents

Taxpayers whose income tax returns are linked to a tax agent [see 47.70] have an additional two months to pay their terminal tax. For example, taxpayers whose terminal tax would normally be due by 7 February have until 7 April to pay their terminal tax if they have a tax agent. This extension of time applies to all taxpayers who have a tax agent, not just to provisional taxpayers. The two-month extension applies only if the tax agent has an extension of time arrangement under s 37 of the TAA.

The extended terminal tax date also applies to ACC premiums paid by self-employed taxpayers [see 10.50].

1150.75 Penalties and interest

For commentary on the penalty and interest provisions applying to provisional tax see the following paragraphs:

(a) Late payment penalty [see 1110.55];

(b) Tax shortfalls [see 1110.85]; and
Provisional taxpayers are able to pool their provisional tax payments and thereby reduce their exposure to use of money interest (UOMI) [see 1110.290]. Provisional tax payments are pooled in an Inland Revenue tax pooling account, which is established and administered by an intermediary. Provisional taxpayers make payments to the intermediary. The intermediary then deposits these payments into the tax pooling account. The intermediary requests Inland Revenue to transfer amounts from the tax pooling account to the individual provisional taxpayer’s account with Inland Revenue once the taxpayer’s year-end tax liability has been determined. Rather than underpayments and overpayments of provisional tax being subject to UOMI, they are offset against those of other provisional taxpayers within the pool. Underpayments and overpayments are charged or credited with interest at market rates by the intermediary, rather than at the UOMI rates.

The following diagram shows how provisional tax pooling works.

A person or company wishing to be an intermediary must apply to Inland Revenue. An application to establish a tax pooling account must state the applicant’s full name, address and tax file number. The application must include statements that:

(a) The applicant has administration and information technology systems in place to protect the privacy of the personal information and payment details of its clients and to record the amount remaining at any time in the tax pooling account for each client taxpayer;

(b) The applicant has established a trust account into which amounts received as an intermediary will be paid;

(c) The applicant, each person acting as an officer of the applicant (if not a natural person), and any principal of the applicant is not a bankrupt, has not been convicted of a dishonesty offence, and is eligible to be a company director; and

(d) The applicant will, before acting as an intermediary for any taxpayer, inform the taxpayer that Inland Revenue is not required to oversee or audit the operation of the tax pooling account, that Inland Revenue is not liable for any loss the taxpayer suffers because of the way the intermediary operates the account, and of the requirements of (a), (b) and (c) above.

If Inland Revenue is satisfied that the applicant will operate the tax pooling account correctly, and the applicant’s information technology systems will allow the applicant to make payments and provide information in a prescribed format, Inland Revenue may give written approval for the applicant to establish a tax pooling account. The tax pooling account is established in the name of the intermediary and continues until wound up. The account does not relate to a particular tax year.

Any provisional taxpayer may contract with a person operating a tax pooling account for that person (ie the intermediary), to act as an intermediary between the provisional taxpayer and Inland Revenue in using the funds from the tax pooling account to meet the provisional taxpayer’s provisional tax obligations.
When an intermediary accepts a payment from a provisional taxpayer for deposit into a tax pooling account, the intermediary must (at or before the time of payment), advise the taxpayer that the payment does not satisfy the provisional taxpayer’s obligation to make a payment to Inland Revenue. It is only once the amount is transferred from the tax pooling account to the provisional taxpayer’s account with Inland Revenue that the obligation is actually satisfied.

An intermediary must maintain and operate administration and information technology systems that protect the privacy of the personal information and payment details of its clients and that record the amount remaining at any time in the tax pooling account for each client taxpayer.

Inland Revenue is not required to oversee or audit the operation of a tax pooling account. Furthermore, Inland Revenue is not liable for any loss suffered by a provisional taxpayer because the intermediary:

(a) Does not deposit a taxpayer’s payment into a tax pooling account;
(b) Makes an unauthorised withdrawal from a tax pooling account; or
(c) Fails to request a transfer of funds from a tax pooling account to a taxpayer’s account with Inland Revenue.

A provisional taxpayer intending to use the services of an intermediary thus needs to first satisfy themselves of the integrity and reliability of the intermediary.

When a deposit is made to a tax pooling account, the intermediary must notify Inland Revenue electronically of the name, tax file number and the amount of the deposit, for each provisional taxpayer. If these details are not provided within five working days, Inland Revenue must refund the deposit. On receipt of a deposit, Inland Revenue must notify the intermediary of the account to which the deposit has been paid, the provisional taxpayers who are recorded as being associated with the deposit and the amount of the deposit that is recorded as being associated with each provisional taxpayer.

The amount paid by a provisional taxpayer to an intermediary for deposit in a tax pooling account is held in trust by the intermediary for the provisional taxpayer until the amount is credited to the provisional taxpayer’s Inland Revenue account, credited to the Inland Revenue account of another provisional taxpayer who is a client of the intermediary, or refunded to the provisional taxpayer.

Use of money interest on an amount deposited in a tax pooling account accrues to the benefit of the intermediary from the date of deposit and is payable to the intermediary on the effective date of the credit of the amount to another Inland Revenue account, or the date the amount is refunded by Inland Revenue to the intermediary. For the purpose of calculating use of money interest, but for no other purpose, an amount deposited into a tax pooling account is treated as tax paid by the intermediary.

An intermediary may at any time request Inland Revenue to transfer an amount from the tax pooling account to a client’s Inland Revenue account. The intermediary can request that the amount be credited on any date on or after the date the amount was deposited into the tax pooling account. Inland Revenue will credit the amount to the provisional taxpayer’s account on the date requested by the intermediary, unless the requested date is in a tax year for which the terminal tax date is more than 60 days before the date on which Inland Revenue receives the transfer request and the provisional taxpayer is liable for a penalty that relates to the provisional taxpayer’s provisional tax obligations for the tax year. Otherwise, the amount will be credited on the date Inland Revenue receives the transfer request.

When requesting a transfer, the intermediary must provide Inland Revenue with the following details electronically:

(a) The date on which the amount is to be transferred and the effective date of the transfer, if different;
(b) The amount to be transferred; and
(c) The tax file number of the taxpayer.

Inland Revenue must not action a transfer if the amount was deposited into the tax pooling account within five days of the transfer request and the details required on deposit have not been provided, or if the information required under (a) to (c) above has not been provided. When an amount has been transferred, Inland Revenue must provide a statement showing the effect of the transfer on the intermediary and the
provisional taxpayer whose account has been credited. An amount transferred and credited to a provisional taxpayer’s account is treated as income tax paid to meet a provisional tax obligation.

Inland Revenue may refuse to accept a request for transfer, or may reverse a transfer, if Inland Revenue considers that the request is made for tax avoidance purposes. An intermediary may request Inland Revenue to refund all or part of the balance in the tax pooling account.

An intermediary may wind up their tax pooling account at any time. Inland Revenue may require an intermediary to wind up their tax pooling account if Inland Revenue considers that:

(a) The intermediary’s actions are preventing a provisional taxpayer from effectively managing their liabilities to pay provisional tax and use of money interest;
(b) The intermediary is, or has been, in breach of their obligations under ss RP 18 to RP 21;
(c) The tax pooling account has gone into deficit;
(d) There are, or are likely to be, consistently fewer than 100 taxpayers using the tax pooling account;
(e) The intermediary, any person acting as an officer of the intermediary (if not a natural person), and any principal of the applicant has been made bankrupt, has been convicted of a dishonesty offence, or is not eligible to be a company director; or
(f) The intermediary has been put into liquidation or receivership.

In the case of (d), Inland Revenue must give the intermediary 30 days notice of the intention to wind up the tax pooling account. When a tax pooling account is wound up, Inland Revenue may at its discretion either refund the funds in the tax pooling account to the intermediary or apply to a court for directions on how the funds should be disposed of.

When an intermediary makes a payment of interest to a client (or vice versa), arising from the operation of a tax pooling account, the payment is:

(a) Income (under s CC 4) to the person who derives the payment. The payment is subject to the RWT or the NRWT rules, as applicable.
(b) Expenditure incurred in deriving the gross income of the person who makes the payment.

Example:
Two provisional taxpayers, A and B, each have standard balance dates. A overpays its provisional tax by $5,000 at each of the instalment dates (28 August, 15 January, 7 May); B underpays its provisional tax by $5,000 at each instalment date. In the absence of an intermediary, A would receive UOMI calculated at the CIR’s lower paying rate whilst B would be charged UOMI calculated at the provisional taxpayer’s higher paying rate [see 1110.290]. If A and B employed the services of an intermediary, and assuming the intermediary it could be expected that the rate received by A would be higher and the rate paid by B would be lower.

1150.80 Dates of payment in a transitional year [s RC 21]
“Transitional year” means the period for which a taxpayer furnishes a return under s 39 of the TAA [s YA 1]. In other words, a transitional year is when the taxpayer’s tax year is not equal to 12 months because the taxpayer has had a change of balance date.

The total amount of provisional tax payable in a transitional year is the total of all provisional tax instalments due in the transitional year, as set out below and in 1150.82.

The interim instalments fall due on the 28th day of the months set out in sch 3, Part B except that 15 January is in place of 28 December (if applicable) and 7 May is in place of 28 April (if applicable). Provisional tax, in the case of interim instalments, is not payable on:

(a) The date of instalment B, if s RC 13 would have applied if the year were not a transitional year;
(b) The dates of instalments B and D, if s RC 14(1)(a) and (b) would have applied if the year were not a transitional year;
(c) The dates of instalments B, D, and F, if the person liable to pay provisional tax is a person with an initial provisional tax liability whose first business day occurs within 30 days of the date of instalment F;
(d) The date of instalment C, if s RC 14(1)(c) would have applied if the year were not a transitional year; or
(e) The dates of instalments C and F, if the person liable to pay provisional tax is a person with an initial provisional tax liability who pays GST on a six-monthly basis whose first business day occurs after the day that is 30 days before the date of instalment F.

The final instalment falls due on the 28th day of the month following the final month in the transitional year; except that this is the 15th day of January when November is the final month, or 7 May, when March is the final month. The calculation of the amounts payable on each instalment are explained in 1150.82.

The number of months in a transitional year is determined as follows. The first month in a taxpayer’s transitional year is the first whole month in that transitional year. For a new provisional taxpayer, the first month in a transitional year is the month following the first business day. The final month in a transitional year is the month in which a taxpayer’s new return date occurs [see 770.50]. Each month falling between the first and final months is counted to determine the length of the transitional year. The months for the payment of provisional tax instalments in a transitional year are outlined below [sch 3, Part B].

(1) Monthly and two-monthly non-ratio and non-GST provisional taxpayers

The months for the payment of provisional tax instalments in a transitional year are:

<table>
<thead>
<tr>
<th>Transitional year length</th>
<th>New instalment months</th>
</tr>
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<td>0–4 months</td>
<td>1 month following final month</td>
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<tr>
<td>5–8 months</td>
<td>2 5th month, month following final month</td>
</tr>
<tr>
<td>9–12 months</td>
<td>3 5th, 9th months, month following final month</td>
</tr>
<tr>
<td>13–16 months</td>
<td>4 5th, 9th, 13th months, month following final month</td>
</tr>
<tr>
<td>17–20 months</td>
<td>5 5th, 9th, 13th, 17th months, month following final month</td>
</tr>
<tr>
<td>21–24 months</td>
<td>6 5th, 9th, 13th, 17th, 21st months, month following final month</td>
</tr>
</tbody>
</table>

(2) Six-monthly non-ratio provisional taxpayers

The months for the payment of provisional tax instalments in a transitional year are:

<table>
<thead>
<tr>
<th>Transitional year length</th>
<th>New instalment months</th>
</tr>
</thead>
<tbody>
<tr>
<td>0–6 months</td>
<td>1 month following final month</td>
</tr>
<tr>
<td>7–12 months</td>
<td>2 7th month, month following final month</td>
</tr>
<tr>
<td>13–18 months</td>
<td>3 7th, 13th months, month following final month</td>
</tr>
<tr>
<td>19–24 months</td>
<td>4 7th, 13th, 19th months, month following final month</td>
</tr>
</tbody>
</table>

(3) GST ratio provisional taxpayers

The months for the payment of provisional tax instalments in a transitional year are:

<table>
<thead>
<tr>
<th>Transitional year length</th>
<th>New instalment months</th>
</tr>
</thead>
<tbody>
<tr>
<td>0–2 months</td>
<td>1 month following final month</td>
</tr>
<tr>
<td>3–4 months</td>
<td>2 3rd month, month following final month</td>
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<td>5–6 months</td>
<td>3 3rd, 5th months, month following final month</td>
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<td>7–8 months</td>
<td>4 3rd, 5th, 7th months, month following final month</td>
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<td>9–10 months</td>
<td>5 3rd, 5th, 7th, 9th months, month following final month</td>
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<td>11–12 months</td>
<td>6 3rd, 5th, 7th, 9th, 11th months, month following final month</td>
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<tr>
<td>13–14 months</td>
<td>7 3rd, 5th, 7th, 9th, 11th, 13th months, month following final month</td>
</tr>
</tbody>
</table>
### Transition year length

<table>
<thead>
<tr>
<th>New instalment months</th>
<th>15–16 months</th>
<th>17–18 months</th>
<th>19–20 months</th>
<th>21–22 months</th>
<th>23–24 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>3rd, 5th, 7th, 9th, 11th, 13th, 15th months, month following final month</td>
<td>3rd, 5th, 7th, 9th, 11th, 13th, 15th, 17th months, month following final month</td>
<td>3rd, 5th, 7th, 9th, 11th, 13th, 15th, 17th, 19th months, month following final month</td>
<td>3rd, 5th, 7th, 9th, 11th, 13th, 15th, 17th, 19th, 21st months, month following final month</td>
<td>3rd, 5th, 7th, 9th, 11th, 13th, 15th, 17th, 19th, 21st, 23rd months, month following final month</td>
<td></td>
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</tbody>
</table>

#### Amount of instalments in a transitional year

- If a taxpayer does not make an estimate of residual income tax (RIT) for a transitional year before an instalment date, and the instalment is not a final instalment, the amount payable on an instalment date is calculated using the following formula:

  \[
  \frac{\text{person's provisional tax} \times \text{instalments payable}}{\text{total instalments}} - \text{tax previously payable}
  \]

  Where:
  
  - "Person’s provisional tax" is the amount of provisional tax previously due and payable for that year;
  - "Instalments payable" is the aggregate number of instalments due in that year before the instalment date;
  - "Total instalments" is whichever of the following applies: Three for a person who pays on instalment dates B, D and F; Two for a person who pays on instalment dates C and F; and
  - "Tax previously payable" is the amount for the transitional year of the provisional tax payable before the instalment date [s RC 22].

- In a transitional year, provisional taxpayers who furnish estimates or revised estimates must:
  - (a) Before the CIR notifies a change of balance date, estimate RIT as if no change in balance date will be approved; and
  - (b) After the CIR notifies a change in balance date, re-estimate RIT.

Once a change of balance date has been approved, and the provisional taxpayer is making an estimate of RIT for the transitional year, the amount payable on an instalment date, other than a final instalment date, is calculated using the following formula:

\[
\frac{\text{tax estimate} \times \text{instalments payable}}{\text{transitional months}} - \text{tax previously payable}
\]

Where:

- "Tax estimate" is the amount of provisional tax last estimated under s RC 5(5);
- "Instalments payable" is either: four multiplied by the number of instalments in the transitional year payable on or before the instalment date if the person pays on the equivalent instalment dates B, D, and F; or six multiplied by the number of instalments in the transitional year payable on or before the instalment date if the person pays on the equivalent instalment dates C and F.
- "Transitional months" is the number of months in the transitional year [see 1150.80];
- "Tax previously payable" is the amount of provisional tax for a tax year calculated on the basis of the transitional year that is payable before the instalment date.

If a taxpayer has not made an estimate of the RIT for a transitional year, the amount payable on a final instalment date is calculated using the following formula:

\[
\frac{\text{person’s provisional tax} \times \text{transitional year days}}{\text{preceding year days}} - \text{tax previously payable}
\]

Where:
“Person’s provisional tax” is the provisional tax liability under s RC 5(2) or (3);
“Transitional year days” is the number of days in the transitional year;
“Preceding year days” is the number of days in the immediately preceding tax year;
“Tax previously payable” is the amount of provisional tax previously due and payable for that year and calculated on the basis of the person’s transitional year that is payable before the instalment [s RC 22].
If a provisional taxpayer makes an estimate of the income tax for a transitional year, the amount payable on a final instalment date is the amount of provisional tax payable less the amount of any instalments previously due and payable.

**1150.83 Provisional tax in years following a transitional year** [s RC 20]
When provisional tax is calculated on the basis of the previous year’s residual income tax (RIT), and the previous year was a transitional year, an adjustment is required to convert the RIT to a full year equivalent amount.
When provisional tax is calculated using:
(a) The 105 per cent method if the preceding tax year is a transitional year; or
(b) The 110 per cent method if the tax year before the preceding tax year is a transitional year,
the provisional taxpayer’s RIT must be calculated using the following formula:
\[(\text{residual income tax} \times \text{days in current tax year}) / \text{days in transitional year}\]
Where:
“Residual income tax” is the RIT for the transitional year;
“Days in current tax year” is the number of days in the current tax year; and
“Days in transitional year” is the number of days in the transitional year [s RC 20(4)].
Until the new balance date is approved, the provisional taxpayer shall use the existing instalment dates up until the time when the new balance date is reached [s RC 25].

**1150.85 Payments set off within wholly-owned group** [s RC 32]
Where a company, included in a wholly-owned group of companies, has paid provisional tax in excess of its RIT, the company may elect to allocate all, or any part of, the excess to any other company included in that tax year in the same wholly-owned group. The excess can be allocated to the extent that the provisional tax paid by the other company is less than its RIT for that year. The company who has overpaid its provisional tax is referred to as the “excess company” and the company that is allocated the excess tax is referred to as the “underpaid company”.
An excess company may make an allocation for a tax year only on, or after, the later of:
(a) The day on which the provisional tax in excess is paid by the excess company; or
(b) The day on which the first instalment of provisional tax payable for the tax year becomes payable by the underpaid company.
An allocation is deemed to be made on the day specified in the notice. Any provisional tax allocated by an excess company to an underpaid company is deemed to be provisional tax paid by the underpaid company and not by the excess company.
The notice of allocation must:
(a) Be in writing;
(b) Name the underpaid company or companies to which the excess is to be allocated, and the amount or amounts so allocated;
(c) Be furnished to the CIR within the time within which a return of income is required to be furnished by the underpaid company or companies, or within further time as the CIR may allow; and
(d) Specify the day on which the excess amount is deemed to be allocated to the underpaid company and the amount of the excess so allocated.

(1) Consolidated group provisional tax [s RC 8]

For commentary on the provisional tax rules for consolidated groups [see 190.65].

1150.90 Life insurer’s provisional tax [s RC 5(8)]

A life insurer must provide the CIR with details of how its provisional tax was calculated. These details must specify the extent to which the provisional tax relates to the policyholder base.
Chapter 1160
Qualifying Companies

1160.05 Purpose
The qualifying companies regime has applied since the 1993 income year. Under this regime closely held companies can be treated in a manner similar to partnerships for income tax purposes. Dividends paid by a qualifying company must be fully imputed to the extent that imputation credits or dividend withholding payment credits are available. To the extent that these credits are not available, the dividends will be exempt. This means that in effect dividends and capital gains can be distributed tax free to shareholders. If the qualifying company is also a loss attributing qualifying company any losses that it makes must be passed on to its shareholders, in proportion to their shareholding. The shareholder can then offset their share of the company’s tax loss against their other income.

A qualifying company retains its corporate status. It also retains its limited liability status, except in respect of the company’s income taxes, as the shareholders generally assume personal liability for their share of the company’s income tax. The definition of qualifying company is given in s HA 2, and the other qualifying companies legislation is found in Subpart HA. See also Inland Revenue’s Booklet Qualifying Companies (IR435).

1160.06 Phase-out of the regime
(1) Restrictions on entry into the regime [s HA 5]
The qualifying company regime is being phased out. Generally, only companies that were qualifying companies (QC) or loss attributing qualifying companies (LAQC) in the “grand-parenting income year” are eligible for inclusion in the regime. The one exception to this rule applies to new companies. These are companies that have not previously been required to file a return of income. These companies are able to
make an election on or before the date on which they are required to file their income tax return for the “grand-parenting income year”.

The “grand-parenting income year” is the year prior to the first income year that starts on or after 1 April 2011. For example, if a company’s balance date is 31 May, the “grand-parenting income year” is the year prior to the one that commences on 1 June 2011. That means that the “grand-parenting income year” is the year that runs from 1 June 2010 to 31 May 2011. For a new company, an election to enter the qualifying company regime would need to be made by the date on which the return for the year ended 31 May 2011 is required to be filed. The election would apply from the year ended 31 May 2011.

Existing QCs and LAQCs (including new companies that enter the regime under the conditions set out above) that do not wish to transition to an alternative business structure are able to continue to use the QC rules. However, continuing LAQCs are no longer able to attribute losses to shareholders.

**1160.07 Transition to other business structures** [ss HZ 4B, HZ 4C, HZ 4D]

(1) **Background**

QCs and LAQCs are able to transition to a new business structure. In order to take advantage of the transition provisions, the company must be QCs or LAQCs in the “grand-parenting income year” (see above).

The transition can occur in either of the two income years immediately following the “grand-parenting income year”. Where it occurs in the latter of these two years, the company must have also met the QC or LAQC criteria for the whole of the first of the two transition years.

The transition rules allow for a QC or LAQC to transition into any one of the following:

(a) A partnership;
(b) A limited partnership;
(c) A look-through company;
(d) A sole trader.

A transition to whichever structure is chosen must be completed by the end of the transition year. This includes the transfer of all assets and liabilities and the completion of all necessary legal documentation. Failure to complete the process in time will result in the corporate structure remaining in place but the QC status will have been lost.

(2) **Transition to partnership or limited partnership** [s HZ 4B]

A transition into a partnership, limited partnership or sole trader can be done at no tax cost.

During the first six months of the chosen transition year, the QC or LAQC must inform the CIR that it intends to transition into a partnership or limited partnership. The notice also serves as a revocation of QC or LAQC status with effect from the beginning of the transitional income year. The tax treatment for the new structure will apply from the beginning of the transitional income year.

The partners of the new partnership must be the same people as those who were shareholders in the QC or LAQC. The one exception to the “same people” rule is that a limited partnership may have a company as its general partner and the shareholders of what was the QC or LAQC as its limited partners.

The partners must also have the same relative interests in the partnership as they had in the QC or LAQC. This includes both assets and liabilities and the associated rights and obligations. If more than one QC or LAQC transition into the same partnership, it is necessary to ensure that their net relative positions in the total merged business remain the same.

Any person who dies during the transitional year is treated as still being a partner for the purposes of the “same people” and “same relative rights” requirements.

Any loss carried forward by the QC can be used by the partners of the new partnership against their share of the income of the new partnership. Where a QC or LAQC has CFC or FIF losses carried forward, the normal country ring-fencing applies.
The effect of the transition is that the partners effectively step into the shoes of the shareholders of the QC or LAQC and are treated as having, on the first day of the transitional income year, the QC’s or LAQC’s historical tax positions. Any balance in the QC’s or LAQC’s imputation accounts is ignored as is any available subscribed capital.

The limited partnership loss limitation rules [see 1050.80] do not affect these carried forward losses. For the purposes of the limited partnership loss limitation rules, the “partners’ basis” formula can be calculated using either:

(a) The market value or accounting book value as at the end of the income year prior to the transitional year of the various amounts in the formula; or
(b) The historic basis, as if the limited partnership rules had always applied.

If the formula results in a partner’s basis that is less than zero, it is deemed to be zero.

(3) Transition to look-through company [s HZ 4C]

Where a QC or LAQC becomes a look-through company, the original company remains in existence. It is only the tax treatment that changes.

All of the shareholders of the existing QC or LAQC must complete an election to become a look-through company [see 920]. The election must be made during the first six months of the chosen transitional year. The election also serves as a revocation of QC or LAQC status with effect from the beginning of the transitional income year. The look-through company then steps into the shoes of the qualifying company in respect of the various elections and methods relating to the qualifying company.

The tax treatment for the new structure will apply from the beginning of the transitional income year. No entry tax is payable on transition into the look-through company regime.

Any loss carried forward by the QC can be used by the owners of the look-through company against their share of the income from the look-through company. Where a QC or LAQC has CFC or FIF losses carried forward, the normal country ring-fencing applies.

For the purposes of applying the look-through company deduction rules [see 920.45], all of the persons who hold owner’s interests are required to choose one of the following two methods for calculating their basis:

(a) The market value or accounting book value as at the end of the income year prior to the transitional year; or
(b) The historic basis, as if the look-through company had always existed and all rules that apply to a look-through company had always applied.

If the calculation results in an owner’s basis that is less than zero, it is deemed to be zero.

(4) Transition to sole trader [s HZ 4D]

Transition to a sole trader can occur only where there is one single shareholder in the QC or LAQC. It cannot occur where there is more than one shareholder.

Any loss carried forward by the QC can be used by the sole trader in future income years. Where a QC or LAQC has CFC or FIF losses carried forward, the normal country ring-fencing applies.

(5) Other matters to be considered

Where a QC or LAQC transitions into a sole trader or partnership, then any income and expenses incurred during the transitional year will be treated as having been derived or incurred by the sole trader or partnership (as the case may be) notwithstanding that, in fact, they were derived or incurred by the QC or LAQC.

Matters such as working partner employment contracts will be deemed to be in place from the beginning of the transitional year. However, a new contract should be entered into once the transition actually occurs.

Partners and sole traders will be self-employed persons for the transitional year and so should ensure that matters such as personal provisional tax payments are made. It may be possible to transfer existing tax balances from the QC or LAQC to the sole trader or partners.
Qualifying companies definition [ss HA 2, HA 5, HA 6, HA 7, HA 8, HA 9, HA 11]

A company is a qualifying company where all of the following apply:

(a) It is not a unit trust [s HA 2];

(b) At all times in the income year, it is resident in New Zealand and not treated by a double tax agreement as not resident (however, it can have one or more non-resident shareholders) [s HA 6(2)];

(c) It has five or fewer shareholders [see 1160.12], or is a flat-owning company (one whose governing instrument provides that each registered shareholder is entitled to occupy or use residential property in New Zealand owned by the company, provided the residential properties are the only significant assets of the company) [s HA 6(1)];

(d) Each shareholder in the company is either:
   (i) A natural person (other than a trustee);
   (ii) A trustee of a trust provided:
       – All dividend income derived by the trustee from the qualifying company during the income year that can, under general trust law, be distributed is beneficiary income of a beneficiary other than:
           (A) A trustee beneficiary; or
           (B) A beneficiary that is a company other than a qualifying company; and
       – At least some of the dividends derived by the trustee from the qualifying company have either vested in, or been distributed to:
           (A) A beneficiary other than a trustee beneficiary; or
           (B) A beneficiary that is a company other than a qualifying company;
           and was beneficiary income of that person [s HA 11(5)].
   (iii) Another qualifying company [s HA 7(1), (2)];

(e) The company does not during the income year derive “foreign non-dividend income” (see below) exceeding $10,000 after deduction of the lesser of any:
   (i) Foreign non-dividend income derived under the accruals rules; or
   (ii) 10 per cent of gross income [s HA 9];

Foreign non-dividend income is income that:

(i) Does not have a source in New Zealand; and

(ii) Is not a dividend; and

(iii) Is not FIF income calculated under the fair dividend rate method.

For the purposes of the limit on foreign non-dividend income for qualifying companies, the definition of non-dividend income does not include foreign investment fund income calculated under the fair dividend rate (FDR) method. This change, backdated to 1 April 2008, has been made to accommodate the effect of the repeal of the grey-list of countries.

(f) The company must not have income interests in a CFC or attributing interests in a FIF that are a direct income interest of 10 per cent or more. If a qualifying company holds a CFC income interest or non-portfolio FIF interest in any income year beginning on or after 1 July 2009 it will immediately cease to be a qualifying company. This prevents qualifying companies from being used as intermediaries to distribute untaxed foreign income to New Zealand shareholders as dividends from qualifying companies are exempt under s CW 15 to the extent to which they are not fully-imputed [s HA 8B];

(g) All directors have made an election that is in effect at all times during the income year and which has not been revoked [s HA 5];
Qualifying Companies

(h) A shareholder election has been made in respect of shareholders who have full legal capacity and the election is in effect at all times during the income year and has not been revoked. Persons who can validly contract and bind themselves by legal obligation uncontrolled by any other person or persons have full legal capacity. Anyone under the age of 18 does not have full legal capacity.

(i) The company has not ceased to be a qualifying company by ceasing to be a loss attributing qualifying company.

In relation to item (d)(ii) above, if the trustee is a shareholder in several qualifying companies and does not distribute dividends from one company to beneficiaries, it is only that qualifying company which will lose its qualifying company status. The status of the other qualifying companies in which the trustee is a shareholder is not affected.

(1) Non-complying companies [ss HA 4, HA 11]

When a company ceases to meet any of the above requirements it ceases to be a qualifying company from the first day of the income year in which it failed to meet the requirement.

Example:
The number of shareholders in QC Ltd increased from five to six on 15 July 20X1. QC Ltd, which has a standard balance date, loses its qualifying company status from 1 April 20X1.

If a company did not know that it would cease to be a qualifying company, the CIR has the power to defer the date on which it ceases to be a qualifying company to the first day of a later income year. To exercise this power the CIR must be satisfied that the company did not know (and could not possibly have expected or ascertained) that it would cease to be a qualifying company whether:

(a) Through a reasonable expectation of a substitute election or other event occurring within any period of grace allowed for following a revocation of a shareholder election or a loss attribution election [see 1160.40];

(b) Through a reasonable expectation that it would not fail to comply with the requirement that during the income year it derives foreign non-dividend income not exceeding $10,000 after appropriate deductions; or

(c) Through a reasonable belief that qualifying company dividend income derived by a trustee would be distributed as beneficiary income.

In applying these provisions, the CIR must give consideration to all of the following matters:

(a) The period of time that has elapsed between the beginning of the income year and the date of failure to comply with any of the requirements of being a qualifying company;

(b) The period of time that has elapsed between the date of failure to comply and the date on which the failure became known, or could reasonably be expected to have become known;

(c) Any transactions of the company during any such period; and

(d) Any other relevant circumstances.

It is not intended that a company lose the benefits of being a qualifying company or a loss attributing qualifying company in any year solely because it liquidates or is formed in that year. The CIR will interpret the qualifying company legislation accordingly [see TIB vol 4:1 (August 1992) at 4].

1160.12 Five or fewer shareholders [ss HA 7(3), YB 21]

The following rules determine the application of the test of five or fewer shareholders:

(a) Shares held by a nominee of any person are regarded as being held by the person and not by the nominee [s YB 21];

(b) Shares in one company held by another company are regarded as being held by the shareholders of the latter company;
(c) A natural person who is a shareholder and all other shareholders related to that shareholder within the first degree by a blood relationship, marriage, civil union, de facto relationship or adoption, are regarded as a single shareholder (e.g., husband and wife, and parent and child are first degree relationships. A sister and brother are related in the second degree);

(d) Where a person becomes a shareholder in a qualifying company (whether through acquiring shares in the company or through the company becoming a qualifying company) and is treated with any other person as being a single shareholder, that person continues to be treated as a single shareholder, regardless of any subsequent death or marriage dissolution, for so long as he or she remains a shareholder in the qualifying company. This protects the situation where there is a break in the first degree of relationship because of a death or dissolution of marriage;

Example:
A father and his children all holding shares in the same company are treated as one person. If the father dies, the group continues to be treated as one person. However, if the father was not a shareholder, but all of his children were, the provision would not apply as each sibling would have been counted separately because they were not within the first degree of relationship with each other.

(e) Where a trustee is a shareholder the deemed number of shareholders in respect of that trust at any time is the greater of:

(i) The number of beneficiaries who, since the first day of the 1992 income year, have derived beneficiary income of dividends from any qualifying company; and

(ii) The number of persons (other than the trustee) who made a shareholder election on behalf of the trust that the company should become a qualifying company.

The trustee is not counted as a shareholder for the five or fewer test.

Example:
The following persons are shareholders in QC Ltd:
Jack Father
Jane Wife (second wife of Jack and stepmother of Paul)
Paul Son
Pauline Paul’s wife
A Ltd A qualifying company with shareholders being Jack, Jane, Paul, and Mary (Jack’s sister), and Joe (unrelated)
Family trust Beneficiaries are Sandra (Jack’s first wife and mother of Paul and Susan), Paul and Susan (aged 12 years)

For the test of five or fewer shareholders, QC Ltd has the following five shareholders:
• Jack, Jane, Paul and Susan, who are counted as one person, being one degree from Jack;
• Mary;
• Joe;
• Pauline;
• Sandra, who was divorced from Jack before the company became a qualifying company.

When applying the five or fewer shareholder test you can start with different shareholders to arrive at the fewest number of shareholders. In the above example, Paul and Susan could be grouped with Sandra instead of Jack. Alternatively, Paul and Pauline could be grouped together. In this particular case, whichever grouping was used, the number of shareholders would be five.

1160.15 Shareholder’s effective interest [s HA 44]
It is necessary to determine each individual shareholder’s effective interest in order to:

(a) Determine the appropriate proportion of a qualifying company’s tax liability that a shareholder assumes;
(b) Determine when certain shareholder elections can be made by majority shareholders [see 1160.30]; and
(c) Serve as a basis for attributing losses of loss attributing qualifying companies.

Example:
A shareholder has a voting interest of 60 per cent for five months and (through a reduction in shareholding) a voting interest of 20 per cent for the remaining seven months in an income year. The effective interest is:

\[
\frac{60}{100} \times \frac{5}{12} + \frac{20}{100} \times \frac{7}{12} = 36.7\%
\]

The shareholder would, therefore, be responsible for 36.7 per cent of the total tax assessed for that income year if the company defaults in payment of its tax; or be entitled to 36.7 per cent of losses if it is a loss attributing qualifying company.

### 1160.20 Director elections [ss HA 5, HA 30, HA 31]

A company is able to be a qualifying company only when, at the time of the notice of election, all directors have made elections in writing to the CIR that the company be a qualifying company. An election by the directors takes effect on the first day of the income year following the election unless a later income year is specified, and remains in force until it is revoked. Any election made by a company which has previously not been required to file an income tax return takes effect on the first day of the company’s income year if it is received by the CIR within the time allowed for the filing of a return for that first income year. The definition of “director” is very wide. It includes anyone occupying the position of director regardless of what the position is called, and includes any person whose instructions the directors are accustomed to following [s YA 1].

An election can be revoked only by a resolution of the board of directors that is notified to the CIR. The revocation is effective from the later of the beginning of the income year in which the CIR receives the revocation, or the beginning of the income year specified in the notice.

### 1160.30 Shareholder elections [ss HA 5, HA 8, HA 30]

A company may only be a qualifying company where every *sui juris* (of full legal capacity) shareholder has elected in writing that the company should become a qualifying company. The requirement to make a shareholder election extends to nominee shareholders. For example, if an accountant holds one share in a company, and the remaining 9,999 shares are owned by a client, the accountant must still make a shareholder election.

In addition, the shareholders must also have elected to be personally liable for their share (based on their effective interest), [see 1160.15] of any income tax not paid by the company and of any income tax not paid by another qualifying company in which the company is a shareholder. The shareholders’ personal liability covers only income tax incurred by the company in respect of the time it is a qualifying company, and does not apply to any other unpaid taxes.

An election remains effective until revoked, and takes effect:
(a) Where the company is not already a qualifying company, from the beginning of the income year following the year the election is made, unless a later year is specified; or
(b) Where the company is already a qualifying company, on the date the CIR receives written notice.

If a company has previously not been required to file an annual income tax return, any election made can take effect on the first day of the company’s first income year if it is received by the CIR within the time allowed for the filing of a return of income for that first income year [see 1160.35].

(1) **Shareholder trustees [s HA 8]**

Where a shareholder is a trustee, the trustee is treated as having made an election only where the trustee and one or more natural persons (who are *sui juris* beneficiaries) assume liability. Where there is no beneficiary who is *sui juris*, a natural person (who may also be the trustee) can assume liability on behalf of the beneficiaries. Written notice is given to the CIR electing that the company should become a qualifying company, and electing to be:
(a) Personally (in the case of a beneficiary or natural person); or
(b) To the extent of the trust’s net assets (in the case of a trustee), jointly and severally liable for the trustee shareholder’s share (based on the trustee’s effective interest [see 1160.15] of any income tax not paid by the company and of any income tax not paid by another qualifying company in which the company is a shareholder).

Whenever a trustee is a shareholder, extra care needs to be taken, especially after the qualifying company election is made, to ensure that the company retains its qualifying company status.

(2) Minority shareholders [s HA 8]

To prevent minority shareholders from preventing a company from becoming a qualifying company, majority shareholders may individually or jointly elect to assume responsibility in the place of minority shareholders. A minority shareholder (ie one with an effective interest of less than 50 per cent) is treated as having made an election where the majority shareholders (ie those with an aggregate effective interest of 50 per cent or more) have elected that the company become a qualifying company, and elected to be personally, jointly, and severally liable for the minority shareholder’s share (based on their effective interest), [see 1160.15] of income tax payable by the company and any tax the company may be liable for as a shareholder in another company.

1160.40 Revocation of shareholder elections [ss HA 32, HA 33, HA 34, HA 35, HA 36, HA 37]

Any shareholder election can be revoked by the person who made it by notice in writing given to both the company and the CIR. The company ceases to be a qualifying company from the first day of the income year in which the notice is received by the CIR, or on the first day of a later income year which may be specified in the notice. If it is necessary to determine the effective interest of the person making the revocation, it is determined on the date the CIR and the company received the notice of revocation or such later date as is specified in the notice [s HA 32].

A shareholder election is also deemed to be revoked in the following circumstances, from the first day of the income year in which the event that caused the revocation occurred:

(a) On the death of the person who made the shareholder’s election. The company will remain a qualifying company after the death of a shareholder, if within a 12-month period of grace following the death (or such extended period as allowed by the CIR upon application by the company, the personal representative of the deceased shareholder, or any other person who may make an election) all of the qualifying company requirements are met. For example, if a shareholder dies and leaves their shares to a person who was not previously a shareholder, the new shareholder (or majority shareholders on their behalf) has 12 months following the death to make a shareholder election [ss HA 33, HA 34];

(b) On sale or disposition of all the shares of a shareholder (who has made a shareholder election), unless the shares are sold or disposed of to an existing shareholder in the company for whose shareholding a valid shareholder election is already in effect [ss HA 33, HA 35];

Example:
Sharon, a shareholder in QC Ltd, sells all of her shares in the company to Peter, who was not previously a shareholder. Peter (or majority shareholders on his behalf) has a 63-day period of grace to make a shareholder election. However, if the sale of shares to Peter means that QC Ltd no longer has five or fewer shareholders [see 1160.12] the company ceases to be a qualifying company and there is nothing QC Ltd can do about it.

The CIR’s policy is that a transfer of shares held by a trustee to a new trustee constitutes a disposal of shares for the purposes of s HA 33 and a new election must be made [see TIB vol 6:5 (November 1994) at 6].
(c) Where an election has been made by both a trustee and a natural person to assume liability on behalf of beneficiaries (because there were no beneficiaries of full legal capacity) and a trust beneficiary attains full legal capacity [s HA 33];

**Example:**
The Jim Family Trust, a shareholder of QC Ltd, has three beneficiaries all of whom are aged under 20. When the first beneficiary, Sally, turns 20 the initial shareholder election in respect of the shares owned by the Jim Family Trust is deemed to be revoked. The trustee and Sally have 63 days to make a new shareholder election. If Sally refuses to make the election QC Ltd will lose its qualifying company status, unless a majority election can be made on behalf of the Jim Family Trust. It is not possible for someone to assume Sally’s responsibility.

(d) Where an election has been made by the majority shareholders who assume liability on behalf of the minority shareholders and the effective interest of a minority shareholder increases to 50 per cent or more [ss HA 33, HA 35];

**Example:**
Mr Smith, Mr Jones, and Ms Black are shareholders in a qualifying company. Their effective interests in the company are:
- Mr Smith, 20 per cent;
- Mr Jones, 40 per cent;
- Ms Black, 40 per cent.

Mr Jones and Ms Black have made a majority election on behalf of Mr Smith. Mr Smith then buys a further 30 per cent of the company’s shares from Mr Jones. Mr Smith’s effective interest in the company is now 50 per cent (an effective interest, if no market value circumstance exists, is the person’s voting interest in the company: see 1160.15). Their effective interests in the company after the sale are:
- Mr Smith, 50 per cent;
- Mr Jones, 10 per cent;
- Ms Black, 40 per cent.

Mr Jones and Ms Black now have a 50 per cent effective interest, which is still enough for a majority election, but Mr Smith has a 50 per cent effective interest which is no longer a minority interest. Therefore, the election on behalf of Mr Smith is deemed to be revoked. If the company is to remain a qualifying company, Mr Smith must make an election within 63 days (or such longer period as the CIR may grant), in which to make an election [see TIB vol 6:5 (November 1994) at 6].

(e) If an election has been made by the majority shareholders who assume liability on behalf of minority shareholders and the effective interest or aggregate effective interests of the majority shareholders then falls below 50 per cent. The company will cease to be a qualifying company unless a new election is made within 63 days [ss HA 33, HA 35];

(f) Where a joint election has been made and one of those persons revokes, or is deemed to have revoked, the election. If the person who made the election dies there is a 12-month period of grace for a new election to be made, otherwise there is a 63-day period of grace [s HA 36].

Sections HA 35 and HA 36 set out the periods of grace within which new elections must be made, or deemed to be made, when shareholder elections have been revoked or deemed to have been revoked. Generally, a substitute election must be made within 63 days of the date of receipt by the company of the notice of revocation. However, in the case of shareholder death, the period of grace is 12 months. If a substitute election is made within the period of grace, the company retains its qualifying company status. In all circumstances the CIR has the power to extend the period of grace on application from the company or any person who may make a shareholder election in respect of the shareholding. In order to exercise the discretion, the CIR must be satisfied that, under the circumstances, it would be unduly harsh or inappropriate to treat the company as having ceased to be a qualifying company.

Additionally, a company does not cease to be a qualifying company where it has issued or allotted any shares to a person other than an existing shareholder or when an existing shareholder attains full legal capacity if within 63 days or such extended period as is allowed by the CIR a valid shareholder election is made in respect of that shareholding.
1160.45 Liability of electing shareholders for company income tax [TAA, s 92AB]

Where a person makes a shareholder election to become liable for a percentage of the company’s income tax:

(a) That person becomes assessable, and liable as an agent for the company, for their share (based on their effective interest), [see 1160.15] of the company’s income tax and of any income tax payable by the company because it has made a shareholder election in respect of another qualifying company. If the shareholder has also made an election on behalf of a minority shareholder they are also liable for the effective interest of that minority shareholder. Shareholders who do not have full legal capacity have no liability because they have not made an election.

(b) No assessment for tax of an electing person and no assessment for tax of the company precludes an assessment being made of the other.

TaxNote: The shareholder liability arises only where the company fails to satisfy its tax liability.

Where a person who is liable for a percentage of the tax payable by a qualifying company first acquires shares in the company, or sells or disposes of his or her whole shareholding, the CIR can reduce the percentage of that person’s tax liability if the CIR is satisfied:

(a) With the support of adequate accounts and other relevant information, that the proportion of the tax liability attributable to the part of the income year, during which the person was a shareholder in the company, is smaller than the proportion that the part income year bears to the whole income year; and

(b) That in all circumstances it would be appropriate to reduce that person’s tax liability accordingly.

1160.50 Shareholder interest deductibility [s DB 9]

Non-cash dividends (other than taxable bonus issues) received by a shareholder from a qualifying company are exempt income. Section DB 9 restricts the amount of interest that a shareholder can claim as a deduction if they have borrowed money to acquire shares in the qualifying company and received non-cash dividends from the qualifying company during the income year. Specifically no deduction is allowed in calculating the net income of the shareholder for interest to the extent of the amount of any non-cash dividends (other than taxable bonus issues) which that shareholder, or any person associated with the shareholder, derives from the company in that income year.

Example:
During the 20X1 income year, Alex, a shareholder in QC Ltd paid $15,000 interest on money he borrowed to buy his shares in QC Ltd. He also received a $5,000 non-cash dividend from QC Ltd. His interest deduction for that income year is limited to $10,000 ($15,000 - 5,000).

The restriction on interest deductibility does not apply to the receipt of exempt cash dividends.

Where the associated person is associated with more than one shareholder in the qualifying company, the amount of any non-cash dividends (other than taxable bonus issues) derived by that person from that company in the income year is apportioned among the shareholders associated with the person in proportion to the effective interest in the company held by each of those shareholders in the relevant income year.

When the shareholder is also an employee, any non-cash benefits received will be subject to fringe benefit tax, and are not dividends. Accordingly, the restriction on interest deductibility will not apply.

1160.55 Taxation of qualifying companies [ss HA 17, CW 14, HA 22]

A qualifying company is taxed in the same way as any other company, but subject to the following rules:
(a) Dividends derived by qualifying companies are generally taxable. Sections CW 10 and CW 11 do not exempt from tax dividends received by a company which at any time before the date of deriving the dividend was a qualifying company [ss HA 17, CW 14]; and

(b) A qualifying company cannot utilise loss offsets from another company or make subvention payments to another company within a group unless the other company is also a qualifying company. However, qualifying company losses may be offset against the taxable income of a non-qualifying company [s HA 22].

1160.60  Qualifying company election tax [ss HA 40, HA 41, HA 42]

On becoming a qualifying company, the company is liable to pay qualifying company election tax (QCET). New companies have no QCET liability. Broadly stated, QCET is payable at 28 per cent on the amount of the company’s reserves that would be taxable if the company was liquidated and net assets distributed to shareholders. This excludes any amounts not ordinarily taxable to shareholders on liquidation, such as capital gains.

The amount of QCET payable, which cannot be less than nil, is calculated according to the formula:

$$\text{QCET} = (\text{dividends} + \text{balances} - \text{assessable income} - (\text{balances} / \text{tax rate}) \times \text{tax rate})$$

Where:

“Dividends” is the sum of the amounts that would be dividends if the company:

(a) Disposed of all its property, other than cash, to an unrelated person at market value for cash; and

(b) Met all its liabilities at market value (excluding income tax payable through disposing of the property or meeting the liabilities); and

(c) Was liquidated, with the amount of cash remaining being distributed to its shareholders without imputation credits or FDP credits attached.

“Balances” is the sum of the following amounts:

(a) The balance in the company’s imputation credit account;

(b) The balance in the company’s FDP account;

(c) Any unpaid income tax for an earlier income year less tax refunds due for the earlier income year; and

(d) Any unpaid FDP for a dividend received less refunds due for a dividend received, where the dividend was received before the date on which the company becomes a qualifying company.

“Assessable income” is the total assessable income that the company would derive by taking the actions described in the meaning “dividends” above less the amount of any deduction that the company would have for taking those actions.

“Tax rate” is the company tax rate for the relevant income year of the company.

If the company pays income tax with a purpose or intention of reducing the amount of QCET payable, the company’s ICA is reduced by the amount of the overpayment that is attributable to that action [s HA 41].

Inland Revenue does not require companies wishing to calculate their QCET liability to obtain formal valuations of assets and liabilities. Inland Revenue require a fair and reasonable valuation rather than a registered valuation. It would be acceptable, for example, for a real estate agent to provide a value for land owned by a company [see TIB vol 4:8 (April 1993) at 1].

Inland Revenue has developed a form that can be used to calculate QCET.

QCET is due on the company’s terminal tax date, for the year prior to the company becoming a qualifying company [s HA 42].

Example:

Small Ltd has a standard balance date. On 4 March 20X1 the shareholders and directors elect for it to become a qualifying company. This takes effect from 1 April 20X1 (the first day of Small Ltd’s 20X2 income year). Any QCET is due and payable on the 20X1 terminal tax date (ie 7 February 20X2, or 7 April 20X2 if Small Ltd has a tax agent).
A revocation made at any time before the end of the income year in which the QCET is payable normally removes the QCET liability. This is because the company becomes a non-qualifying company throughout the whole of the income year in which the revocation is made [see TIB vol 6:7 (December 1994) at 6].

QCET is not included in the term “income tax paid”. However, from 17 May 2007, QCET gives rise to a credit in the company’s imputation credit account (ICA) as a result of its payment. This is designed to stop companies contemplating winding up from electing to be a qualifying company and paying QCET on untaxed reserves at 30 per cent. A company that did that would then be able to distribute any untaxed reserves to the shareholders tax free, thus paying only 30 per cent tax instead of the shareholders rate, which could well be significantly higher. With QCET credited to the ICA, the reserves on which it was paid will be taxable when distributed to shareholders.

The CIR may make and issue assessments for QCET and late payment penalty, and taxpayers may follow the challenge process available [TAA, s 94].

QCET is also payable where a non-qualifying company amalgamates with a qualifying company. This applies where it is the qualifying company that continues in existence following the amalgamation. The amalgamated company is liable for the payment of any QCET arising on amalgamation. Any tax loss of the non-qualifying company is forfeited on amalgamation [s HA 40(2)].

### 1160.62 Forfeiture of losses [s HA 21]

In the income year in which a company becomes a qualifying company, any losses carried forward from previous years are forfeited and can no longer be carried forward. Losses incurred in the income year in which the company becomes a qualifying company and in any subsequent years can be carried forward.

**Example:**

Small Ltd had net losses of $12,500 carried forward from the 20X1 and 20X2 income years. Small Ltd became a qualifying company on 1 April 20X2 and the $12,500 net losses were forfeited. Small Ltd then makes a $5,000 net loss for the 20X3 income year. The $5,000 can be carried forward to subsequent income years.

### 1160.65 Qualifying company dividends [ss HA 14, HA 15, HA 16]

Broadly speaking, cash dividends paid by a qualifying company, including a loss attributing qualifying company, to a New Zealand resident shareholder must be fully imputed to the extent that imputation credits or dividend withholding payment credits are available. Credits are attached to dividends at the end of the income year in which the dividends have been paid. The amount of the fully-imputed distribution is calculated under the formula contained in s HA 15(2) (see below). To the extent to which the dividends exceed the fully imputed figure, they are exempt. Dividends paid to non-residents are subject to non-resident withholding tax, in the same manner as dividends paid by a non-qualifying company.

The formula is:

\[
\text{Full imputation credit} = \frac{\text{Attached imputation credit} + \text{Attached FDP credit}}{\text{Tax rate}}
\]

Where:

“Attached imputation credit” is the lesser of

(a) The maximum imputation credit that may be attached to the dividend by applying the maximum permitted ratio under s OA 18 (modified by changing the tax rate to an earlier company tax rate if s OZ 8 applies); and

(b) An amount calculated using the formula:

\[
\text{Attached credits} = \frac{\text{Attached credits} \times \text{amount of dividend}}{\text{amount paid before credits attached}}
\]

“Attached credits” is the balance in the company’s imputation credit account or FDP account, as applicable, on the last day of the tax year in which the dividend is paid (before a debit is made in respect of the dividend); “Amount of the dividend” is the amount before any imputation credits or FDP credits, as applicable, are attached;
“Amount paid before credits attached” is the total amount of dividends (excluding non-cash dividends other than taxable bonus issues) paid by the company during the tax year before any imputation credits or FDP credits, as applicable, are attached.

If the qualifying company is a FDPA company the company is treated as having attached a FDP credit to the dividend. The amount of the FDP credit is the lesser of:

(a) The maximum FDP credit that may be attached to the dividend under s OA 18, taking into account any imputation credit attached to the dividend as calculated above; and

(b) An amount calculated using the formula:

\[
\text{(attached credits} \times \text{amount of dividend)} / \text{amount paid before credits attached}
\]

The following rules apply to dividends paid by qualifying companies to New Zealand resident shareholders:

(a) Any unexpired 10-year bonus issue returned to shareholders before expiry of the 10-year period is income in the hands of the shareholder;

(b) Sections CW 9, CW 10, and CW 11 do not apply to treat a dividend paid to a corporate shareholder as exempt income;

(c) Any dividend (or part thereof) that is exempt income in the hands of trustee shareholder retains its exempt status upon distribution to New Zealand resident beneficiaries of the trust [s HA 16];

(d) Resident withholding tax (RWT) need not be deducted from qualifying company dividends, because they do not constitute resident passive income [s HA 14];

(e) Where the shareholder has a late balance date and the dividend is derived between 31 March and that balance date, the dividend is treated as if it was derived by the shareholder immediately following that balance date [s HA 14];

(f) An exempt dividend that is paid to trustees continues to be exempt when it is distributed to beneficiaries as beneficiary income [s HA 16];

(g) The amount of any imputation credit or dividend withholding payment attached to any dividend is debited to the company’s imputation account or dividend withholding payment account respectively on the date the company paid the dividend [s HA 19];

(h) A company dividend statement must be completed by the company showing all dividends paid, including taxable bonus issues (but not other non-cash dividends) whether or not any imputation credits or dividend withholding payment credits are attached. The statement must separately detail the gross and exempt dividends. It is required to be completed by 31 May following the end of the imputation year and filed with Inland Revenue;

(i) Likewise, a shareholder dividend statement containing similar details must be completed by the company in respect of all dividends paid and be given to each shareholder;

(j) In addition a company should, on request by a shareholder, include in the shareholder dividend statement details of the amount of non-cash dividends paid to the shareholder. Non-cash dividends paid to shareholders who are not employees are exempt, but the deduction that the shareholder can claim for interest is reduced by the amount of any non-cash dividends received [see 1160.50].

1160.68 **Imputation credit accounts** [ss OA 8(3B), RM 13, RM 32, OA 8(3B)]

There are some special rules that apply to qualifying companies’ imputation credit accounts (ICAs). Under s RM 13, the amount of an income tax refund paid to an ICA company is generally limited to an amount equal to the credit balance of the ICA at the end of the most recently ended imputation year (or later if certain rules apply) [see 670.65]. However, s RM 32 states that this limitation does not apply to qualifying companies, unless the tax was overpaid through an avoidance arrangement.
Example:
At 31 March 20X1, QC Ltd had a nil balance in its ICA. QC Ltd had overpaid its 20X1 provisional tax by $5,000. The $5,000 can be refunded to QC Ltd even though it will result in a debit balance in QC Ltd’s ICA. If QC Ltd was not a qualifying company the $5,000 could not be refunded.

Furthermore, under s OB 67, qualifying companies do not have to pay 10 per cent imputation penalty tax or further income tax if, at the end of an imputation year, there is an uncleared debit balance in their ICA that arises solely from the refund of income tax paid by the company [see 670.55 and 670.60].

Example:
Carrying on from the above example, if QC Ltd made no tax payments during the income tax year ended 31 March 20X2, it will have a $5,000 debit balance in its ICA at 31 March 20X2. Under the special rules that apply to qualifying companies, QC Ltd will not have to pay the further income tax or imputation penalty tax, which would have otherwise been due by 20 June 20X2. The deficit is instead carried forward to be offset against credits arising in the following income year.

The minimum shareholder continuity requirements for imputation credit accounts or dividend withholding payment accounts applying to non-qualifying companies do not apply to qualifying companies.

Upon ceasing to be a qualifying company:
(a) References relating to imputation credits and dividend withholding payment credits to the end of the year relate to the day immediately preceding the date when the company ceases to be a qualifying company;
(b) The imputation credit account is debited with the credit balance held in the account (before any credits attached);
(c) The dividend withholding payment account is debited with the credit balance held in the account (before any credits attached); and
(d) The shareholder continuity requirements apply from the day on which the company’s status as a qualifying company ends.

1160.70 Imputation credits and dividend withholding payment credits attached to dividends [s HA 15]

(1) Imputation credits
The imputation credits to be attached to dividends paid during the income year are calculated at the end of that income year.

When a qualifying company pays a dividend (other than non-cash dividends which are not taxable bonus issues) the imputation credits to be attached to that dividend are the lesser of:
(a) The credit available if the maximum imputation ratio was used; and
(b) An amount calculated according to the formula in s HA 15(2) [see 1160.65].

(2) Dividend withholding payment credits
When a qualifying company which keeps a separate dividend withholding payment account pays a dividend (other than non-cash dividends which are not taxable bonus issues), the dividend withholding payment credits to be attached to that dividend are the lesser of:
(a) The maximum permitted through the dividend withholding payment ratio calculation, after taking into account any imputation credit also attached (the combined imputation credits and dividend withholding payment credits can not exceed the maximum ratio of 30/70); or
(b) An amount calculated according to the same formula as is used for imputation credits but using the balance in the company’s FDP account instead of the balance in the ICA account.

These rules relate only to dividends paid to resident shareholders. Dividends paid to non-resident shareholders are subject to non-resident withholding tax and the rules relating to imputation credits and dividend withholding payment credits for non-qualifying companies.
**1160.75  Loss attributing qualifying companies [ss HA 1, HA 3, HA 4, HA 5, HA 10, HA 12, HA 38]**

For income years commencing on or after 1 April 2011, LAQCs are unable to attribute losses to shareholders. Instead, they are treated as being qualifying companies. For discussion of the loss attribution rules applying before that date, see *Staples Tax Guide 2011*.
Chapter 1180

Racing and Trotting

1180.10 Breeding or racing

The breeding and racing of bloodstock are closely related because a breeder’s objective is to breed a horse which will win races for the breeder or for some future owner, and/or be suitable for producing saleable progeny. However, for income tax purposes, there is a distinction between the two activities, and racing stakes won are exempt income.

It is sometimes difficult to distinguish between an activity which constitutes a business, the profits from which are taxable, and one which is a mere “hobby”, the profits from which are not taxable [see 130 BUSINESS]. The distinction between business and hobby is central to determining whether or not the proceeds of the sale of bloodstock are subject to tax.

1180.15 Exempt income [ss CW 47, CW 60]

Income derived by the following bodies is exempt income:

(a) The New Zealand Racing Board;
(b) The New Zealand Thoroughbred Racing;
(c) Harness Racing New Zealand;
(d) The New Zealand Greyhound Racing Association (Inc);
(e) Any “racing club” as defined in s 5 of the Racing Act 2003 if no amount income or club funds is used by or available to be used for the pecuniary profit of any member of the club or associate of a member.

Stake or prize money for any horse race, trotting race, or dog race is exempt income where it is paid by any club licensed to use the totalisator under the Racing Act 2003, or if the race is held outside New Zealand.

1180.20 Replacement breeding stock [s EC 48]

The CIR may allow the whole or part of the net gain from either:

(a) The sale of any breeding stock; or
(b) A payment received by way of insurance, indemnity, compensation or other damages for the loss or death of, or permanent injury to, any breeding stock,
to be offset against the cost of any bloodstock which has been acquired as replacement stock. “Net gain” means the amount by which the gross proceeds received exceeds the book value of the lost, dead, or injured stock. “Breeding stock” means bloodstock used in breeding operations or purchased for such use.

An application must be in writing not later than six months after year end, or within such further period as the CIR considers reasonable. The replacement bloodstock must be acquired before the application is made. Where there are valid commercial reasons for a delay in replacement, and replacement stock is acquired before the end of the second income year following the year in which the loss, death, or permanent injury of the animal occurred, a refund of the tax already paid on the assessable gain may be allowed. The application should be in writing and made before the end of the second income year following the year of loss, death, or permanent injury.

Example 1:
During the 20X1-X2 year a bloodstock breeder, Mr Stable, sold one of his broodmares for $100,000. Its book value at 31 March 20X1 was $50,000. His net gain was therefore $50,000. In April 20X2 he bought a replacement broodmare for $120,000, and then applied to the CIR to offset the net gain against the cost of the replacement. The CIR approved the application. The cost price of the replacement broodmare for tax purposes was therefore $70,000 (being $120,000 cost less $50,000 net gain offset).

Example 2:
A high-quality broodmare owned by Mr Bridle, a bloodstock breeder, died in January 20X1. As a suitable replacement could not be found in New Zealand, Mr Bridle visited stud farms in America. Finally, in April 20X2, he bought another mare. He received insurance proceeds of $350,000. The book value of the first mare at the time of its death was $200,000. The net gain was therefore $150,000. He included the gain in his 20X1-X2 income tax return. The cost of the new mare was $500,000. In June 20X2 he applied to the CIR for a refund of the tax paid on the assessable gain and for a reduction of the cost of the replacement mare. The application was received within two years of the end of the 20X0-X1 year, and the CIR was satisfied there were valid commercial reasons for the delay. The tax paid on the net gain was refunded and the cost of the replacement mare was reduced by $150,000.

1180.25 Cost of bloodstock

“Bloodstock” is defined in s YA 1 as any standard-bred or thoroughbred horse, including any interest or share in any such horse. All bloodstock is valued at cost subject to an annual write-down. The cost of a share in any breeding stock is able to be written down at the specified rate applying to full owners.

(1) Inland Revenue Policy

The following information regarding the CIR’s approach to determining the cost of bloodstock is taken from PIB 166 (November 1987).

The costs of purchasing or breeding are capitalised until the year in which the animal is first used for breeding purposes by that owner. Costs arising during or subsequent to that year are deductible in full.

The cost used for purchased bloodstock (other than in-foal mares — see below), is the cost price plus the costs of delivery. The cost used for home-bred bloodstock (including the progeny of a mare purchased in-foal) is:

(a) The service fee for the stallion used in the breeding; plus

(b) The depreciation allowed on the breeding mare in the year of servicing.

General farm costs are not significant in bloodstock breeding.

The cost of home-bred bloodstock progeny includes, inter alia, the specified writedown of the mare in the year of foaling, not in the year of servicing: TRA Case S12 (1995) 17 NZTC 7,102.

Where a taxpayer who breeds a foal also owns the stallion that provides the service, the service fee element of cost can be taken as:

(a) The market value of the stallion’s service; or

(b) Direct costs of the stallion divided by the number of mares serviced in the income year. The direct costs are depreciation on the stallion and insurance in the income year of servicing.
Where a mare is purchased in-foal, a portion of the price represents the service fee. The cost of the service fee needs to be subtracted from the cost of the mare and allocated to the cost of the foal. However, a mare may be purchased for less than the cost of the service fee plus the value of the mare before servicing. In other cases, the value of the service fee may not be known. In such situations, a cost allocation needs to be made.

(a) Where an in-foal mare is purchased for less than the value before servicing plus the service fee, the following calculation is used [see Example 1]:

\[
\text{cost allocated} = \frac{\text{value of service fee for mare}}{\text{value of mare plus service fee}} \times \text{price of mare}
\]

(b) Where an in-foal mare is purchased for more than its value before servicing but the cost of service is unknown [see Example 2]:

\[
\text{cost allocated to foal} = \text{price of mare} - \text{value of mare before servicing}
\]

(c) Where an in-foal mare is purchased but the value before servicing and the cost of service are unknown [see Example 3]:

\[
\text{cost of foal} = \text{value of foal}
\]

### Example 1:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>In-foal mare purchased for</td>
<td>$15,000</td>
</tr>
<tr>
<td>Mare’s value before servicing</td>
<td>$10,000</td>
</tr>
<tr>
<td>Service fee</td>
<td>$8,000</td>
</tr>
<tr>
<td>Cost allocated to foal ($8,000 + $18,000 × $15,000)</td>
<td>$6,667</td>
</tr>
<tr>
<td>Cost of mare ($15,000 − $6,667)</td>
<td>$8,333</td>
</tr>
</tbody>
</table>

### Example 2:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>In-foal mare purchased for</td>
<td>$15,000</td>
</tr>
<tr>
<td>Mare’s value before servicing</td>
<td>$12,000</td>
</tr>
<tr>
<td>Cost allocated to foal ($15,000 − $12,000)</td>
<td>$3,000</td>
</tr>
<tr>
<td>Cost of mare</td>
<td>$12,000</td>
</tr>
</tbody>
</table>

### Example 3:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>In-foal mare purchased for</td>
<td>$25,000</td>
</tr>
<tr>
<td>Foal valued at</td>
<td>$13,000</td>
</tr>
<tr>
<td>Cost of foal (ie its value)</td>
<td>$13,000</td>
</tr>
<tr>
<td>Cost of mare ($25,000 − $13,000)</td>
<td>$12,000</td>
</tr>
</tbody>
</table>

In some cases a mare may be leased by a stud. The lease charges can be treated in the same way as depreciation (ie deductible to the lessee and able to be allocated to the cost of a foal).

1180.30 Valuation of bloodstock [ss EC 39, EC 40, EC 41, EC 42, EC 43, EC 44, EC 45, EZ 5, EZ 6]

“Bloodstock ” is defined in s YA 1 as any standard-bred or thoroughbred horse, including any interest or share in any such horse.

Bloodstock is brought to account for income tax purposes at cost price less a write-down. In order to qualify for write-down, the mare or stallion must be two years of age or older. Subject to this age restriction, the write-down commences at the end of the year in which the bloodstock is:

(a) First used by a taxpayer for breeding purposes in the taxpayer’s bloodstock breeding business; or
(b) Purchased with the intention of being used for breeding purposes in the taxpayer’s bloodstock breeding business; or
(c) Owned by a taxpayer who is in the business of breeding bloodstock and who has formed the intention of using that bloodstock for breeding purposes.

(1) Stallions: Acquired or first used for breeding from 1 August 2006 [s EC 41]
The cost price of stallions acquired or first used for breeding on or after 1 August 2006 is written down to \$1 on a straight-line basis at the rate of 50 per cent of cost price per annum. Alternatively, the taxpayer may choose to use a write-down of 75 per cent of the diminishing value per annum.

In order to qualify for the 50 per cent and 75 per cent rates the stallion must not have been used for breeding in New Zealand prior to 16 December 1991, or used for breeding in New Zealand by any other person before its acquisition. However, there are three exceptions to the rule. The 50 per cent and 75 per cent rates may be used notwithstanding that the stallion has been used for breeding in NZ prior to 16 December 1991 where any one or more of the following apply:

(a) The other person transferred the stallion to the taxpayer by way of a relationship agreement under s FB 18 [see 960.15];
(b) The other person was a company in the same wholly-owned group of companies as the taxpayer; or
(c) For each year in which the stallion was used in New Zealand for breeding, it was owned by a non-resident, was removed from New Zealand after the breeding season, and was not subject to a write-down for New Zealand tax purposes (ie the stallion was a “shuttle stallion”).

TaxNote: The write-down for shuttle stallions is available only from 1 April 2008.

(2) Stallions: Acquired or first used for breeding before 1 August 2006 [s EZ 5]
The cost price of stallions acquired or first used for breeding before 1 August 2006 is written down to \$1 on a straight-line basis at the rate of 25 per cent of cost price per annum. Alternatively, the taxpayer may choose to use a write-down of 37.5 per cent of the diminishing value per annum.

In order to qualify for the 25 per cent and 37.5 per cent rates, the following two conditions must be met:

(a) The stallion must not have been used for breeding in New Zealand prior to 16 December 1991; and
(b) Before its acquisition by the taxpayer, the stallion must not have been used for breeding in New Zealand by any other person unless that other person transferred the stallion to the taxpayer by way of relationship agreement or the other person was a company in the same wholly-owned group of companies as the taxpayer.

Where the above conditions are not met, the rate of write-down is 20 per cent straight-line per annum based on cost price with no diminishing value equivalent [s EC 42].

(3) Broodmares: Acquired or first used for breeding from 1 August 2006 [ss EC 41, EC 42]
The write-down for broodmares acquired or first used for breeding on or after 1 August 2006 is dependent on two factors. These are:

(a) Whether or not the broodmare was first used for breeding prior to 1 April 2001; and
(b) Whether the broodmare has previously been used for breeding purposes by any other person, unless that other person transferred the broodmare to the taxpayer by way of relationship agreement or the other person was a company in the same wholly-owned group of companies as the taxpayer.

If the broodmare was not used for breeding in New Zealand before 1 April 2001, its cost is written down to \$1 on a straight-line basis over a maximum of six years (for broodmares that begin breeding at two years of age) with the cost of broodmares aged eight and older being written down in full in the year in which they are first used for breeding.

If the broodmare has previously been used for breeding in New Zealand, its cost is written down to \$1 on a straight-line basis over a maximum of seven years (for broodmares that begin breeding at two years of age)
with broodmares aged eight and older being written down in full in the year in which they are first used for breeding.

(4) **Broodmares: Acquired or first used for breeding before 1 August 2006 [ss EZ 5, EZ 6]**

The rate of write-down applying to broodmares is dependent on two factors. These are:

(a) Whether or not the broodmare was first used for breeding prior to 1 April 2001; and

(b) Whether the broodmare has previously been used for breeding purposes by any other person, unless that other person transferred the broodmare to the taxpayer by way of relationship agreement or the other person was a company in the same wholly-owned group of companies as the taxpayer.

If the broodmare was not used for breeding before 1 April 2001, its cost is written down on a straight-line basis to $1 by the age of 11 or over three years whichever is longer. If it was used for breeding before 1 April 2001, its cost is written down to $1 by the age of 14 or over three years whichever is longer.

In either case, the rate of write-down is increased by 25 per cent where the broodmare has not previously been used for breeding purposes by another person unless that other person transferred the broodmare to the taxpayer by way of relationship agreement or the other person was a company in the same wholly-owned group of companies as the taxpayer.

(5) **Infertility, birth deformity, or accident [s EC 43]**

If, by reason of infertility, birth deformity, or accident, the market value of any bloodstock on hand at the end of any income year is less than 50 per cent of the market value that would have applied had that incident not occurred, the taxpayer is entitled to value that bloodstock at the end of that income year at its market value. This commits the taxpayer to valuing that bloodstock at the market value at the end of each subsequent income year.

**1180.32 Leased bloodstock [ss CC 11, CC 12, CH 6, DZ 14, EJ 10, EZ 4, FA 6, FA 8, FA 9, FA 10, FA 11]**

The tax treatment of bloodstock leases is dependent on the terms of the particular lease in question. Factors that will impact on the treatment include the length of the lease, whether or not there is an option to purchase the bloodstock at the end of the lease term, and whether or not the lease is on arms-length terms. However, neither the personal property lease provisions of s EJ 10, nor the finance lease provisions in ss FA 6 to FA 1, CC 11, CC 12 and CH 6, apply to bloodstock.

**TaxNote:** A hire purchase agreement for bloodstock is an excepted financial arrangement under s EW 5.

Product ruling BR Prd 05/03 (5 December 2002 to 9 February 2005) and BR Prd 05/04 (10 February 2005 to 4 December 2007), give certainty to the tax treatment of bloodstock which is leased from New Zealand Bloodstock Leasing Ltd and which is used in breeding bloodstock progeny [see TIB vol 17:3 (April 2005) at 8-11].

In order for the rulings to apply, all of the following conditions must be met:

(a) The customer is in the business of breeding bloodstock;

(b) The customer has entered into the “Bloodstock Lease to Purchase Agreement” for the sole purpose of breeding from the leased bloodstock and intends to use that bloodstock in the production of assessable income;

(c) The lease payments are genuine, arms-length amounts;

(d) The leased bloodstock is mature and is capable of being used for breeding throughout the lease period;

(e) Any racing undertaken by the leased bloodstock is merely incidental;

(f) The lessee will have title to any progeny produced during the lease term;

(g) The bloodstock becomes the property of the customer only when the payment of the residual value is made after the lease termination date;
The residual value of the bloodstock is a reasonable estimate of the likely market value of the bloodstock at the lease termination date; and

The residual value amount when paid by the customer is not materially less than the open market value of the bloodstock at the lease termination date.

Where these conditions are satisfied, the following tax treatment results:

(a) The bloodstock lease payments are allowable deductions.

(b) At the end of an income year, the unexpired portion of any lease payments is subject to the prepaid expenditure rules [see 1140.10].

(c) The bloodstock valuation and specified write-down provisions apply when the bloodstock is purchased by payment of the Residual Value after the Lease Termination Date [see 1180.30].

(d) The cost price of the bloodstock is the Residual Value stated in the agreement.

(e) The general anti-avoidance rules do not apply.

(f) The financial arrangements rules do not apply.

(g) The operating lease provision, s EJ 10, does not apply.

(h) The finance lease provisions in ss FC 8A to FC 8I do not apply.

(i) The agreement is not treated as a hire purchase arrangement.

**TaxNote:** The ruling applies only to the agreement specified in it. However, similar arrangements may have similar tax outcomes.

**1180.35 Bloodstock used as a racehorse** [ss DW 2 EC 46, EC 47]

Where a taxpayer is in the business of breeding bloodstock, any bloodstock that the person uses for racing is treated as being so used as part of the bloodstock breeding business. If the bloodstock is being raced other than as part of the breeding business, the taxpayer is able to make application to the CIR that the bloodstock be treated as not being used in the breeding business.

Where the owner expects that the bloodstock will not be able to be used for breeding in the future, any use of the bloodstock for racing is not treated as being part of the breeding business. However, if the animal is being raced as part of the breeding business, application can be made to the CIR for it to be treated as such.

Any application must be made in writing with supporting documentation within one month after the day on which the bloodstock is first prepared for racing or is first raced, whichever is earlier.

Any change of use of bloodstock between being used in the breeding business and being used outside the breeding business is treated as occurring at market value.

Where the breeder races a horse as part of the breeding business to enhance the value of the horse or the stud, deductions are available for non-race related costs such as insurance, agistment, or veterinary costs. No deductions are available for the costs of racing the horse [s DW 2].

**1180.40 Deductibility of racing expenses** [s DW 2]

The following expenses are not deductible even where they are incurred by a breeder in carrying on the business of breeding bloodstock:

(a) The cost of preparing any bloodstock for racing. This does not include any expenditure or loss in preparing that bloodstock for sale where the person is in the business of breeding bloodstock and do not race the bloodstock on which the costs are incurred;

(b) The cost of racing bloodstock. Expenditure not directly related to racing is deductible to the stud owner in business.
Racing and Trotting

1180.45  Trainers
The limitations on the deductibility of expenses [see 1180.40] do not apply to trainers where the costs are incurred on bloodstock that the trainer is preparing for another person and the trainer receives assessable income for preparing that bloodstock for sale.

A taxpayer carrying on a business as a trainer of horses for racing is often able to acquire an interest in a horse. In TRA Case G53 (1985) 7 NZTC 1,229, the taxpayer’s method of apportionment of expenses was upheld. The taxpayer based the apportionment on the variable expenses of the training business and excluded from apportionment the fixed expenses on the grounds that these were incurred solely for business purposes and were not influenced by whether or not he had a racing interest in some of the horses that he trained. However, on appeal the High Court in Commissioner of Inland Revenue v Eales (1987) 9 NZTC 6,203 (HC) held, that once it was accepted that there was a private element in the expenditure for the variable costs, it was impossible not to extend that to apply equally to all other business costs. The distinction between fixed and variable costs was regarded as irrelevant.

Cases frequently arise where an owner and trainer enter into an arrangement (eg partnership or lease) entitling each to a percentage of the stakes won. Where the trainer’s interest is registered, any stake money paid to the trainer is exempt from tax and no deduction is allowable for expenses incurred in racing the particular horse.

A trainer’s interest must be registered where it is in excess of 10 per cent of the total interests. The amount received by the owner is treated as stake money and is accordingly exempt. This principle was confirmed in TRA Case Y22 (2008) 23 NZTC 13,238.

1180.50  Taxability of betting gains
Generally, money won from betting is not income and therefore not assessable. In Graham v Green (Inspector of Taxes) [1925] 2 KB 37, it was held that:

“A bet is merely an irrational agreement that one person should pay another person something on the happening of an event. A agrees to pay B something if C’s horse runs quicker than D’s, or if a coin comes one side up rather than the other side up. There is no relevance at all between the event and the acquisition of property. The event does not really produce it at all. It rests, as I say, on a mere irrational agreement.”

However, in several cases, winnings from betting have been held to be assessable. Almost without exception, these cases turn on special circumstances, and it is only rarely that betting transactions are so organised that they could be classed as a business carried on by a taxpayer. There appears to be no recorded case of a punter, whose life is otherwise dissociated from racing, being held liable for tax on betting gains, even where the transactions extend over a period of years.

In Duggan v Commissioner of Inland Revenue [1973] 1 NZLR 682 (SC), the taxpayer was a wool and skin buyer, but the results of the business over an eight-year period (according to the tax returns filed) were disappointing. Despite this, the taxpayer’s assets over the same period increased substantially. The CIR attributed the source of the increase to the business and, accordingly, considered the taxpayer’s returns to be fraudulent or wilfully misleading. The CIR argued in the alternative that, even if the increase came from race winnings, as the taxpayer alleged, such winnings were taxable income in the circumstances of the case. On appeal in the Supreme Court, Cooke J pointed out that the onus was on the taxpayer to show not only that the assessments were wrong but by how much they were wrong. His Honour was prepared to accept the taxpayer’s evidence that he had placed bets at race meetings regularly and systematically, and had had considerable success from time to time. However, his Honour considered that the taxpayer had failed to discharge the onus to show that he had won $27,000 in the eight-year period. Regarding the alternative submission, on which his Honour reserved his opinion, his Honour had regard to the regularity of the taxpayer’s betting, his frequent attendance at weekday as well as weekend meetings, his adoption of a “system”, and extent of his financial dependence on the winnings. He considered that this was a case where the winnings were taxable, notwithstanding the decision in Graham v Green (above). His Honour cited Commissioner of Taxes v McFarlane [1952] NZLR 349 (CA):
“Where income is in fact derived from betting activities which are engaged in, not with the motive of making casual gains or merely for sport or amusement, but with the motive of making an income, it is difficult to see on what principle such income can be differentiated from any other form of income.”

In an Australian case, *Case 7* (1978) 23 CTBR (NSW), two partners in a restaurant business were assessed on an asset betterment basis following an investigation of their affairs by tax inspectors. They claimed that the improvement in their asset position had been brought about by betting winnings. The three member Commonwealth Taxation Board of Review unanimously held that the taxpayers had made betting winnings and that, therefore, the assessments must be excessive. Two members considered that the taxpayers had thus discharged the burden of proof that the assessments were wrong; but the third member considered that the taxpayers should go further and demonstrate the quantity of the excess. The third member’s views were in line with those of the New Zealand Courts, which have held that it is necessary for a taxpayer, in displacing the onus of proof, to show not only that the assessments are excessive but by how much: *Lancaster v Commissioner of Inland Revenue* [1969] NZLR 589 (SC).

### 1180.55 Bookmakers

Bookmaking is a business, although illegal. Profits derived are assessable and losses incurred may be carried forward. Fines for breaches of the Gaming Act are not deductible. By reason of their occupation, bookmakers’ records are usually incomplete and it is, therefore, difficult for a bookmaker to arrive at a true income. If the CIR has reason to believe that the income returned does not closely approximate the true income, an arbitrary assessment may be issued, thus placing the onus on the bookmaker to establish that the assessment is excessive, and the extent of the excess.

A taxpayer with income from illegal sources has the same rights and obligations for tax purposes as any other taxpayer. Challenges to an assessment or to a ruling given by the CIR may be pursued and there is the legal right to secrecy.

A bookmaker who bets on their own account is assessable on winnings from this source. If there are losses on the betting transaction, these may be deducted from the bookmaking commissions: *Z v Commissioner of Taxes* (1948) 5 MCD 652.

In *Z v Commissioner of Taxes* (1948) 5 MCD 652 the taxpayer, who had himself owned and raced horses, acted as agent for a syndicate of owners and for individual owners in placing bets for them with bookmakers. Commissions earned on these bets were admitted as income. He also betted regularly and profitably on his own account. His success was explained as being due to his using the knowledge gained through his agency for owners who avoided the totalisator so that it would appear to the betting public that the horses were not well backed. In the case of doubles, he was in a position to know the opinion on each owner on his horse’s prospects, an advantage which neither owner might have. He did not attend race meetings but carried on his agency and his own betting activities by telephone from home. On appeal, the assessment was upheld on the facts.

### 1180.60 Jockeys and drivers

Jockeys and drivers in business are assessable on gross riding fees, less travelling and other expenses incurred in the production of their income. The gross fees are subject to withholding tax of 20 cents per dollar for jockeys and drivers and casuals and 15 cents per dollar for resident apprentice jockeys and drivers, whether the payments are fees, remuneration, prize money, appearance money, or otherwise. Non-resident jockeys and drivers have withholding tax deducted at 20 cents per dollar.

Some racehorse owners place bets for the benefit of their jockeys/drivers and trainers. Any proceeds paid to them are income and are in the same category as bonuses, etc, paid directly.

In *Commissioner of Taxes v McFarlane* [1952] NZLR 349 (SC), the taxpayer was a jockey, and the question at issue was whether the taxpayer’s betting gains were taxable. The Court of Appeal decided that the betting transactions were so organised with the taxpayer’s calling as to be part and parcel of it, or to amount to a business connected with it, and that, accordingly, the betting gains were assessable.
Chapter 1190

Rates of Tax

1190.10 Rates of tax [s BB 1; TAA, s 92A]
The rates of income tax may be fixed from time to time by an Act commonly referred to as an annual taxing Act. Schedule 1 of the ITA 2007 sets out the basic rates of income tax currently in force. The basic rates shown in sch 1 are amended from time to time by amendment Acts. The use of amendment Acts removes the necessity for Parliament to pass a separate Act each year to fix the income tax rates.

Even if the rates of tax for an income year have not been set by Parliament, the CIR can still proceed with the issue of assessments at the basic rates set out in sch 1 for the previous income year. If new annual rates of tax are subsequently fixed at a higher or lower level, any assessments already issued for the year may be increased or decreased accordingly.

1190.15 Individuals
The basic rates of income tax for individuals from 1 October 2010 are:

<table>
<thead>
<tr>
<th>Taxable Income Range</th>
<th>Tax Rate</th>
<th>Cumulative Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 – $14,000</td>
<td>10.5%</td>
<td>$1,400</td>
</tr>
<tr>
<td>$14,001 – $48,000</td>
<td>17.5%</td>
<td>$7,350</td>
</tr>
<tr>
<td>$48,001 – $70,000</td>
<td>30%</td>
<td>$13,950</td>
</tr>
<tr>
<td>Exceeds $70,000</td>
<td>33%</td>
<td></td>
</tr>
</tbody>
</table>

As the new rates apply from midway through the income year, the rates for full income year ended 31 March 2011 are a composite of the old and new rates. The composite rates are:

<table>
<thead>
<tr>
<th>Composite tax rates for 2010-2011 income year</th>
<th>Cumulative tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 – $14,000</td>
<td>$1,610</td>
</tr>
<tr>
<td>$14,001 – $48,000</td>
<td>$8,155</td>
</tr>
<tr>
<td>$48,001 – $70,000</td>
<td>$15,085</td>
</tr>
<tr>
<td>$70,001 and over</td>
<td></td>
</tr>
</tbody>
</table>

1190.20 Resident companies
The basic rate for New Zealand resident companies and public authorities is 28 per cent of taxable income. From the 2008-09 to 2010-11 income years, the rate was 30 per cent.
**1190.25 Non-resident companies**
The basic rate of income tax for non-resident companies is 28 per cent, which is the same as the rate for resident companies. From the 2008-09 to 2010-11 income years, the rate was 30 per cent. From the 1996-1997 to 2007-2008 income years, the rate was 33 per cent. Before the 1996-1997 income year, the rate for non-resident companies was 38 per cent.

**1190.30 Trustee income**
On all taxable income of a trustee (whether or not the trustee is a company or a corporation) the basic rate of tax is 33 per cent. Taxable distributions from non-qualifying trusts are taxed at 45 per cent.

**1190.35 Maori Authorities**
The basic rate of income tax for the taxable income of a Maori authority is 19.5 per cent. Prior to the 2004-2005 income year, the rate was 25 per cent.

**1190.40 History of rates for individuals**
The table below shows the rates of tax applying on income derived during the income years specified.

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate %</th>
<th>Cumulative tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 – $6,000</td>
<td>20.00</td>
<td>1,200.00</td>
</tr>
<tr>
<td>Above $6,000 – $24,000</td>
<td>32.00</td>
<td>6,960.00</td>
</tr>
<tr>
<td>Above $24,000 – $25,000</td>
<td>41.06</td>
<td>7,370.60</td>
</tr>
<tr>
<td>Above $25,000 – $30,000</td>
<td>45.10</td>
<td>9,625.60</td>
</tr>
<tr>
<td>Above $30,000 – $38,000</td>
<td>56.10</td>
<td>14,113.60</td>
</tr>
<tr>
<td>Exceeds $38,000</td>
<td>66.00</td>
<td></td>
</tr>
</tbody>
</table>

* A composite tax rate applied: this combined the rates applying from 1 April 1984 to 30 November 1984 and those applying from 1 December 1984 to 31 March 1985.

1985-1986

| $0 – $6,000 | 20.00 | 1,200.00 |
| Above $6,000 – $25,000 | 33.00 | 7,470.00 |
| Above $25,000 – $30,000 | 45.10 | 9,725.00 |
| Above $30,000 – $38,000 | 56.10 | 14,213.00 |
| Exceeds $38,000 | 66.00 |         |

1986-1987

| $0 – $6,000 | 17.50 | 1,050.00 |
| Above $6,000 – $9,500 | 24.00 | 1,890.00 |
| Above $9,500 – $25,000 | 31.50 | 6,772.50 |
| Above $25,000 – $30,000 | 37.55 | 8,650.00 |
| Above $30,000 – $38,000 | 52.05 | 12,814.00 |
| Exceeds $38,000 | 57.00 |         |

1987-1988

<p>| $0 – $9,500 | 15.00 | 1,425.00 |
| Above $9,500 – $30,000 | 30.00 | 7,575.00 |</p>
<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate %</th>
<th>Cumulative tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exceeds $30,000</td>
<td>48.00</td>
<td></td>
</tr>
<tr>
<td>$0 – $9,500</td>
<td>19.50</td>
<td>1,852.50</td>
</tr>
<tr>
<td>Above $9,500 – $30,000</td>
<td>27.00</td>
<td>7,387.50</td>
</tr>
<tr>
<td>Above $30,000 – $30,875</td>
<td>36.00</td>
<td>7,702.50</td>
</tr>
<tr>
<td>Exceeds $30,875</td>
<td>40.50</td>
<td></td>
</tr>
</tbody>
</table>

### 1989-1990 to 1995-1996

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate %</th>
<th>Cumulative tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 – $30,875</td>
<td>24.00</td>
<td>7,410.00</td>
</tr>
<tr>
<td>Exceeds $30,875</td>
<td>33.00</td>
<td></td>
</tr>
</tbody>
</table>

### 1996-1997

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate %</th>
<th>Cumulative tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 – $30,875</td>
<td>22.125</td>
<td>6,831.09</td>
</tr>
<tr>
<td>Above $30,875 – $34,200</td>
<td>24.375</td>
<td>7,641.56</td>
</tr>
<tr>
<td>Exceeds $34,200</td>
<td>33.00</td>
<td></td>
</tr>
</tbody>
</table>

### 1997-1998

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate %</th>
<th>Cumulative tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 – $34,200</td>
<td>21.50</td>
<td>7,353.00</td>
</tr>
<tr>
<td>Exceeds $34,200</td>
<td>33.00</td>
<td></td>
</tr>
</tbody>
</table>

### 1998-1999

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate %</th>
<th>Cumulative tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 – $34,200</td>
<td>20.00</td>
<td>6,840.00</td>
</tr>
<tr>
<td>Above $34,200 – $38,000</td>
<td>22.875</td>
<td>7,709.25</td>
</tr>
<tr>
<td>Exceeds $38,000</td>
<td>33.00</td>
<td></td>
</tr>
</tbody>
</table>

### 1999-2000

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate %</th>
<th>Cumulative tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 – $38,000</td>
<td>19.50</td>
<td>7,410.00</td>
</tr>
<tr>
<td>Exceeds $38,000</td>
<td>33.00</td>
<td></td>
</tr>
</tbody>
</table>

### 2000-2001 to 2007-2008

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate %</th>
<th>Cumulative tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 – $38,000</td>
<td>19.5</td>
<td>7,410.00</td>
</tr>
<tr>
<td>Above $38,000 – $60,000</td>
<td>33.0</td>
<td>14,670.00</td>
</tr>
<tr>
<td>Exceeds $60,000</td>
<td>39.0</td>
<td></td>
</tr>
</tbody>
</table>

#### 1 April 2008 to 31 September 2008

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate %</th>
<th>Cumulative tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 – $38,000</td>
<td>19.0</td>
<td>$7,220</td>
</tr>
<tr>
<td>Above $38,000 – $60,000</td>
<td>33.0</td>
<td>$14,480</td>
</tr>
<tr>
<td>Exceeds $60,000</td>
<td>39.0</td>
<td></td>
</tr>
</tbody>
</table>

#### 1 October 2008 to 31 March 2009

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate %</th>
<th>Cumulative tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 – $14,000</td>
<td>12.5</td>
<td>$1,750</td>
</tr>
<tr>
<td>Above $14,000 – $40,000</td>
<td>21.0</td>
<td>$7,210</td>
</tr>
<tr>
<td>Above $40,000 – $70,000</td>
<td>33.0</td>
<td>$17,110</td>
</tr>
<tr>
<td>Exceeds $70,000</td>
<td>39.0</td>
<td></td>
</tr>
</tbody>
</table>

### 2008-2009 (Composite Rates)*
Rates of Tax

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate %</th>
<th>Cumulative tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 - $9,500</td>
<td>13.75</td>
<td></td>
</tr>
<tr>
<td>Above $9,500 - $14,000</td>
<td>16.75</td>
<td></td>
</tr>
<tr>
<td>Above $14,000 – $38,000</td>
<td>21.00</td>
<td></td>
</tr>
<tr>
<td>Above $38,000 – $40,000</td>
<td>27.00</td>
<td></td>
</tr>
<tr>
<td>Above $40,000 – $60,000</td>
<td>33.00</td>
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<tr>
<td>Above $60,000 – $70,000</td>
<td>36.00</td>
<td></td>
</tr>
<tr>
<td>Exceeds $70,000</td>
<td>39.00</td>
<td></td>
</tr>
</tbody>
</table>

* A composite tax rate applied: this combined the rates applying from 1 April 2008 to 30 September 2008 and those applying from 1 October 2008 to 31 March 2009.

2009-2010

| $0 – $14,000        | 12.5%       | $1,750         |
| $14,001 – $48,000   | 21%         | $8,890         |
| $48,001 – $70,000   | 33%         | $16,150        |
| Exceeds $70,000     | 38%         |                |

1190.45 History of rates for resident companies

<table>
<thead>
<tr>
<th>Income year</th>
<th>Tax Rate %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1977-1978 to 1985-1986</td>
<td>45</td>
</tr>
<tr>
<td>1988-1989</td>
<td>28</td>
</tr>
<tr>
<td>1989-1990 to 2007-2008</td>
<td>33</td>
</tr>
<tr>
<td>2008-2009 to 2010-2011</td>
<td>30</td>
</tr>
</tbody>
</table>
Chapter 1210
Records of Taxpayers

1210.10 Statutory requirements

Appropriate records must be kept and retained by every person who:

(a) Carries on any business in New Zealand;

(b) Carries on any other activity (other than as an employee) in New Zealand for the purpose of deriving assessable income. This includes those taxpayers who receive schedular payments;

(c) Is a person to whom the ESCT rules apply and who makes an employer’s superannuation contribution to a superannuation fund;

(d) Is a person to whom the RSCT rules apply and who makes a retirement savings scheme contribution to a retirement savings scheme;

(e) Makes, holds or disposes of any investment for the purpose of deriving assessable income;

(f) Is an employer or person who provides fringe benefits to employees;

(g) Has a research and development tax credit under s LH 2 (applies for the 2008-2009 income year only);

(h) Is a listed research provider under s LH 15 (applies for the 2008-2009 income year only);

(i) Is an employer whose employees receive payroll donation tax credits [s RD 13B] (from 6 January 2010);

(j) Is an imputation credit account (ICA) company, a foreign dividend payment account (FDPA) company, a branch equivalent tax account (BETA) company, a BETA person, a policyholder credit account (PCA) company, or PCA person;

(k) Is a resident foreign trustee of a foreign trust.

Sufficient records must be kept in New Zealand and in the English language to enable Inland Revenue to readily ascertain:

(a) The assessable income derived by that person from the carrying on of that business, or the carrying on of that other activity, or the making or holding or disposing of that investment;

(b) The deductions of that person in the carrying on of that business, or the carrying on of that other activity, or the making or holding or disposing of that investment;

(c) Every fringe benefit, and the taxable value of every fringe benefit, provided by the person to any person in relation to whom the person is an employer, and every fringe benefit provided by the person to any person who in relation to another person is an employee, those records to include (without limiting the generality of the preceding provisions of this paragraph) details of the recipient of the fringe benefit, the occasion of the providing of it, and the amount (if any) paid or payable by the employee for the receipt or enjoyment of it;
Records of Taxpayers 1210.10

(d) Every foreign dividend received by that person;
(e) Every credit and debit to the person’s memorandum accounts (other than a CTR account and an ASC account), and the amount of a credit attached to a dividend or distribution paid by the person;
(f) The amount of the person’s research and development tax credit under s LH 2 (applies for the 2008-2009 income year only);
(g) The person’s compliance with s LH 15, if the person is a listed research provider, to show:
   (i) They meet the start-up requirements and other continuing requirements; and
   (ii) The amounts derived and incurred by them in performing the research and development activities on behalf of other persons (applies for the 2008-2009 income year only);
(h) The transfer of an amount of an employee’s payroll donation to the recipient of the donation under s 24Q of the TAA (from 6 January 2010);
(i) Every employer’s superannuation contribution, and the taxable value of that contribution, made by the person to any superannuation fund, those records to include (without limiting the generality of the preceding provisions of this paragraph) details of the recipient of the employer’s superannuation contribution, the occasion of making it, and any related tax credit under s MK 1(2);
(j) Every retirement scheme contribution, and the taxable value of that contribution, made by the person to any retirement savings scheme, those records to include (without limiting the generality of the preceding provisions of this paragraph) details of the recipient of the retirement scheme contribution and the occasion of making it; and
(k) The financial position of the foreign trust.

However, there is provision for the CIR to authorise that certain records may be kept outside New Zealand or in a language other than English. Written application, for such approval, should be made to the CIR. In standard practice statement INV-470: Applications to keep records in Maori, the CIR advised that from 1 May 1998 the CIR will generally approve applications to keep records in Maori provided the taxpayer complies with the requirements of ss 24 and 25 of the GSTA (relating to tax invoices, and credit and debit notes), and numbers are recorded using Arabic numerals (0, 1, 2, 3 etc) [see TIB vol 10:4 (April 1998) at 46-48].

The records are to be held for at least seven years after the end of the income year to which they relate, but no records need to be kept if:
(a) The CIR has advised the taxpayer, in writing, that retention of records is not required; or
(b) The taxpayer is a company which has been liquidated.

The seven-year retention period can be increased by up to three years by the CIR where the taxpayer is or has been under audit or investigation, or where such action is contemplated. The CIR must give notice of the intended extension before the expiry of the seven-year retention period. See 1210.20 for the definition of “records”.

If there is more than one resident foreign trustee of a foreign trust, the resident foreign trustees may appoint one of themselves as an agent for the purposes of keeping the required records of the foreign trust. Taxpayers who are not required to file a return [TAA, s 33A], and who are required to retain records of income that has been taxed at source, need retain those records only for 12 months after the end of the income year to which they relate.

The CIR is empowered to reduce the record retention period to 12 months following the end of the income or tax year for classes of taxpayers who are not provisional taxpayers, and records relating to payments from which tax has been deducted at source.

Similar retention periods exist where a return is transmitted to the CIR by electronic means and the return itself is retained by the taxpayer. A return need not be retained if the CIR has given written notice that retention is not required, or if the return relates to a liquidated company. Copies of employer monthly schedules also do not need to be retained [TAA, s 23].
In *TRA Case N21* (1991) 15 TRNZ 758, it was held that the fact that the objector failed to keep proper records of his business dealings does not mean that his explanations should not be accepted.

### 1210.20 Business records [TAA, s 22(1), (7)]

The term “records” includes:

(a) Books of account (in manual, mechanical or electronic format) recording receipts or payments or income or expenditure;

(b) Vouchers, bank statements, invoices, receipts, and such other documents as are necessary to verify entries in the books of account;

(c) Accounts (in manual, mechanical or electronic format) to be maintained under imputation rules, the FDP rules, or s OA 3 (for accounts under subparts OE and OJ, and ss OP 97 to OP 108), and any statement to be retained under ss 31 or 71 of the TAA;

(d) In the case of a foreign trust (other than for the period for which s 59B(3) of the TAA applies):
   
   (i) Documents that evidence the creation and constitution of the foreign trust;
   
   (ii) Particulars of settlements made on, and distributions made by, the foreign trust, including the date of the settlement or distribution, the name and address (if known) of the settlor of the settlement, the name and address (if known) of the recipient of the distribution; and
   
   (iii) A record of:
      
      (A) The assets and liabilities of the foreign trust;
      
      (B) All entries from day to day of all sums of money received and expended by the trustee in relation to the foreign trust and the matters in respect of which the receipt and expenditure takes place; and
      
      (C) If the trust carries on a business, the charts and codes of accounts, the accounting instruction manuals, and the system and programme documentation which describes the accounting system used in each income year in the administration of the trust;

(e) For the purposes of claiming research and development tax credits, other documents evidencing research and development activities.

The specific kinds of business records which are required to be kept include:

(a) A record of the assets and liabilities of the business;

(b) A record of receipts and payments, and the matters to which they relate;

(c) The charts and codes of accounts, the accounting instruction manuals, and the system and programme documentation which describes the accounting system used in each income year in the carrying on of the business; and

(d) Where the business involves the provision of services, a record of services provided and the associated invoices.

Where the business involves dealing in goods, the following additional records are required to be kept:

(a) A record of all goods purchased, and of all goods sold in the carrying on of that business (except those sold in the course of cash retail trading customarily conducted in a business of the kind of which that business is one) showing the goods, and the sellers and buyers or, as the case may be, the agents of the sellers and buyers in sufficient detail to enable the goods, and the sellers and buyers, and those agents, to be readily identified by the CIR; and all invoices relating to the goods;

(b) Statements (including quantities and values) of trading stock held by the person at the end of each tax year, and all records of stocktakings from which any such statement of trading stock has been, or is to be, prepared;

(c) A taxpayer, other than a low-turnover taxpayer, must retain all accounting records relating to the calculation of the value of closing stock;
(d) A low-turnover taxpayer must retain records of the valuation methods and their application in calculating the value of closing stock, except if the methods and their application are not materially different from the previous income year; and
(e) The low-turnover taxpayer must comply with s EB 22(4) [see 1400.35].

Where the business involves the provision of services, a record of services performed and the associated invoices must be kept.

1210.30 Wage records [TAA, s 24]

An employer who makes a PAYE income payment to an employee must keep a proper record relating to the employee, showing the amount of the PAYE income payment before tax and the amount of the tax withheld from it, and the amount of any payroll donation, and must enter those amounts in the record at the time of making the PAYE income payment.

For any pay period in which a person acts as a PAYE intermediary for an employer in relation to an employee:
(a) The intermediary must keep a proper record of their actions as a PAYE intermediary in respect of the employee; and
(b) The employer must keep a proper record of the employer’s payments to the intermediary of salary or wages in respect of the employee.

Every employer (or PAYE intermediary) must take all reasonable precautions for the safe custody of all records that the employer (or PAYE intermediary) is required to keep, and of all pay sheets, receipts for PAYE income payments, withholding certificates, tax code notifications, tax code declarations, tax code certificates, and certificates of entitlement. Such records, pay sheets, receipts, tax code declarations, tax code certificates, and certificates of entitlement must be retained for not less than seven years after the making of the payments to which they relate except and to the extent that the employer (or the PAYE intermediary) is required to deliver to the CIR or to any other person the signed withholding certificates, tax code notifications, tax code certificates, and any certificate of entitlement.

A person is not required to keep any records, pay sheets, receipts, tax code notifications, tax code certificates, or certificates of entitlement in respect of which the CIR has notified the employer or the PAYE intermediary that retention is not required.

1210.40 Retention of business records in electronic form

Standard practice statement IR-SPS GNL-430 sets out Inland Revenue guidelines on the retention of business records stored in electronic form, and on microfilm or microfiche [see TIB vol 15:12 (December 2003) at 57-61]. The statement also provides guidelines on the information and assistance required when Inland Revenue requests information and requires access to business records and supporting background materials. The statement applies from 21 November 2003, the date the Electronic Transactions Act 2002 (ETA) came into force.

Business records may be kept in either paper-based or electronic form. Where records are held in electronic form, they must be kept in a manner that allows Inland Revenue to readily ascertain the amount of tax payable. Persons who do business via the Internet are required to keep business records of all Internet transactions for tax purposes.

Some emails may be classified as business records required to be kept for tax purposes. Where emails are business records, s 27 of the ETA requires the origin, destination and time of electronic communications to be retained and accessible so as to be usable for subsequent references.

Regardless of how business records are retained there must be sufficient detail to ensure a complete audit trail that allows the retained records to be traced to and from accounting records and to tax returns. The ETA provides the option of using technology to store source paper documents by electronic means, and sets the standard for retaining information in electronic form. Inland Revenue considers that the information will be readily ascertainable and meet the requirements of the ETA if taxpayers follow the procedures set out in 1210.45 to 1210.60.
The electronic or microfilmed records must be retained for the full retention period required by the TAA and
the GSTA, currently seven years unless extended to 10 years by Inland Revenue for specific case situations.
Business records stored in electronic form must be stored in data centres physically located in New Zealand.
Back up business records stored offshore do not breach record keeping obligations provided the primary
business records are stored in New Zealand. See Inland Revenue Alert RA 10/02, 10 December 2010.

1210.45 Retention of records on microfilm or microfiche

Paper records that are microfilmed must be copied completely and accurately. The microfilmed records, when
reproduced in printed form, must be identical in format and in all other respects to the original records. The
addition of information such as indexing references is acceptable. The additional information must not
obscure the view of the original record information and must be distinguishable as additions to the original
record.

The quality of the microfilmed records must be sufficient to ensure they are readily accessible and capable
of being retrieved on legible hard copies if required. Paper records microfilmed in accordance with the
requirements detailed below may be destroyed after transfer to microfilm.

1210.50 Transfer of records to electronic form

Paper records transferred to electronic form must be copied completely and accurately. For example, the use
of imaging to provide information in a format identical in all respects to the source document. The addition
of information such as index referencing is acceptable. The additional information must not obscure the view
of the original record information and must be distinguishable as additions to the original record.

The electronic copy must be readily accessible and capable of being retrieved on legible hard copy or supplied
in electronic form (on electronic media and unencrypted in a form able to be read by Inland Revenue staff),
if required. Source-paper documents or other non-electronic records from which the complete information
is transferred and stored in electronic form, in accordance with the requirements of the ETA and the Electronic
Transactions Regulations 2003, may be destroyed after transfer to the electronic form.

1210.55 Electronic record system standards

Internal controls must be adequate to ensure that all business transactions executed electronically, including
those executed through the Internet, are completely and accurately captured. Taxpayers should be able to
demonstrate that their electronic records systems are secure from both unauthorised access and data
alterations. This usually involves developing and documenting a security programme that:

(a) Establishes controls to ensure that only authorized personnel have access to electronic records;
(b) Provides for backup and recovery of records;
(c) Ensures that personnel are trained to safeguard sensitive or classified electronic records; and
(d) Minimises the risk of unauthorised alteration, addition or erasure.

The charts and codes of accounts, the accounting instruction manuals, and the system and program
documentation that describes the accounting system used must be retained and produced, if required, to an
Inland Revenue officer.

The electronic copy must be readily accessible and capable of being retrieved and produced as legible hard
copy or supplied in electronic form (on electronic media and unencrypted in a form able to be read by Inland
Revenue officers) if required. The CIR may approve the use of symbols and abbreviations to facilitate the
electronic transfer of tax invoices, credit notes or debit notes. Requests for approval should be made in writing
to Inland Revenue.

Those who engage in the electronic transfer of tax invoices, credit notes or debit notes must retain electronic
records that in combination with any other records (eg the underlying contracts, price lists, price changes and
product code descriptions), have an adequate level of detail to meet the requirements of the GSTA. For
example, if a hard copy invoice is requested, the printout must contain all information as required under
s 24 of the GSTA.
Backup and recovery procedures must be sufficient to guarantee the availability of electronic records for the required record retention period.

Adequate viewing and printing facilities should be made available free of charge to Inland Revenue officers. If requested, persons must locate selected records that have been stored and print any items selected, free of charge, to Inland Revenue officers. Persons must be available to explain the operation of their computer system to Inland Revenue officers. This is the case whether the system is owned and operated by the person or outsourced to a third party. There must be sufficient detail to ensure a complete audit trail that allows the retained records to be traced to and from accounting records through to tax returns.

1210.60 Storage of electronic records

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

The CIR may approve the storage of records offshore. Approval is subject to the records being readily available in New Zealand on request, in English, and at no cost to Inland Revenue in obtaining the information. Each case will be considered on individual merit, having regard to the person’s compliance history and whether storage overseas is likely to impede Inland Revenue compliance activities.

Inland Revenue’s Computer Tax Audit Unit and electronic data coordinators specialise in downloading electronically stored information. The preferred media for receiving electronic information is CD, DVD or floppy disk. However, other media may be accepted such as 8mm tape cartridge, Zip drives or 4mm DAT tapes. An alternative method is transfer of data between personal computers. Other mutually agreeable transfer methods may be negotiated as required.

When possible, electronic information supplied to Inland Revenue should be in a fixed record length format, in EBCDIC or ASCII or delimited. Tapes should be created without software compression. The electronic information should be copied to media, not to a proprietary back up. Documentation should be supplied with the media showing the record layout, record length (block size if supplied on tape), and number of records.
Chapter 1215

Refunds and Transfer of Excess Tax

1215.10  Refunds of income tax [ss RM 2, RM 4, RM 5, RM 6, RB 4, RM 10]

The CIR must refund an amount of tax paid by a taxpayer if the CIR is satisfied that the amount is in excess of the tax properly payable. The requirement to refund is contingent on the four-year period for amendment of assessments under s 108 of the TAA not having expired [s RM 2].

The CIR must refund an amount of tax paid by a taxpayer if the tax was paid as a result of an amendment to an assessment increasing the amount of tax payable, and the CIR is satisfied that the amount is in excess of the tax properly payable. The requirement to refund is contingent on the four-year period for amendment of assessments under s 108 of the TAA not having expired [s RM 4].

The CIR has discretion to offset a tax refund against a person’s tax liabilities that have not been paid and are due and payable. Whilst the CIR determines the offset in the first instance, taxpayers may request that a refund be used to offset an outstanding tax liability other than that determined by the CIR [ss RM 4, RM 10].

The CIR has no authority to offset a tax refund when the refund arises from:

(a) Tax credits for families;
(b) A refund of excess resident withholding tax; or
(c) A refund of excess non-resident withholding tax.
Refunds and Transfer of Excess Tax

The CIR may write-off tax, refrain from making an assessment, or refrain from recovering or refunding tax, if:

(a) The balance of tax payable is not more than $20; or
(b) The tax paid or deducted is $5 or less than the amount of tax for which the taxpayer is liable [TAA, s 174AA].

However, the taxpayer retains the right to request a refund in all cases. An overpayment of tax can arise in, for example, the following situations:

(a) The taxpayer has paid charitable donations;
(b) The taxpayer is entitled to a rebate which was not included in the PAYE tax code;
(c) The taxpayer has worked for only part of the year;
(d) Salary or wages was earned at fluctuating rates during the year; or
(e) Deductible expenses exceeded income from another source, and tax credits for PAYE were not claimed.

No special form of application for a refund is required, but it must be in writing signed by the taxpayer or an authorised agent. Formal wording is not essential. The application should request the overpayment be refunded or dealt with in some other manner. It should be made within the time limit specified above. If it is not made within that time, the right to a refund may be lost.

If a taxpayer makes a request within the statutory period to have an assessment reopened for the purpose of allowing an additional exemption or rebate and is informed by the CIR that the allowance does not apply, but later it is found that tax has been overpaid through an error in the computation of the tax and the taxpayer then requests a refund of the overpayment, it is the practice of the CIR to decline the application on the ground that specific objection was not made within the statutory period.

The Inland Revenue website contains an on-line personal tax summary calculator which enables taxpayers to calculate whether or not they are due for a refund [see www.ird.govt.nz/calculators/tool-name/tools-p/calculator-pts-calculator-2008.html]. Refunds can arise from having worked for less than the full year, having more than one job during the year, or by having allowable deductions. If a refund is due, the person can then request an summary income statement/personal tax summary for the year.

1215.15 Refunds to be by direct credit [TAA, s 184A]

All refunds made by Inland Revenue of tax paid in excess must be made by direct credit to a bank account nominated by the taxpayer. The taxpayer must provide the particulars of the bank account at the time the refund is claimed. The refund can be made to any registered bank, private savings bank, credit union, building society, or the Public Service Investment Society Ltd.

For these purposes, “tax” is defined as in s 3(1) of the TAA (broadly, any tax, levy, or duty imposed by any tax law), together with any tax credit under s 41A of the TAA, the approved issuer levy, cheque duty, financial support under the Child Support Act 1991, KiwiSaver deductions, and student loan repayment obligations.

Inland Revenue can pay a tax refund by other means if doing so by direct debit would result in undue hardship to a taxpayer, or is not practicable.

1215.20 PAYE to be credited against tax assessed [s LA 6]

PAYE tax deductions received by the CIR in relation to an employee for an income year must be credited successively against:

(a) Any income tax liability of the employee for the income year;
(b) Any income tax liability of the employee that has not been satisfied for any earlier income year;
(c) Any income tax liability of the employee that has not been satisfied for any subsequent income year, in the order of those years;
(d) Any provisional tax due by the employee that has not been paid for any subsequent income year, in the order of those years.
Refunds and Transfer of Excess Tax

Any tax deductions not so credited may be treated as transferable if requested by the taxpayer [see 1215.34]. Any remaining balance must be refunded to the employee by the CIR in accordance with s RM 2 [see 1215.10] and the TAA 1994. If the amount credited against an employee’s income tax liability for an earlier income year is less than the income tax liability for that year, the amount credited must be applied in satisfaction of the income tax liability, so far as it extends.

The amount credited or refunded may not exceed the sum of the tax deductions received by the CIR and any family tax credit paid to the employee if the amount of tax deductions shown in the employer monthly schedule was deducted from source deduction payments made to the employee by the employer.

If the CIR considers that any detail in the employer monthly schedule is incorrect, a tax deduction must not be credited against an income tax liability, nor must a tax deduction be refunded. A credit or refund can be processed once the CIR is satisfied that the particulars received are correct [s LB 1].

If a person has been allowed a credit of tax in excess of the amount properly allowable under a tax law, the CIR may recover the excess from the person in the same manner as if the excess were income tax payable [TAA, s 165A].

1215.30 Transfers of overpaid tax [TAA, ss 173K, 173U]

When a taxpayer overpays their tax (for example, when provisional tax paid exceeds residual income tax for a year), the excess can either be refunded or transferred to another tax period, tax type or taxpayer. The rules in Part 10B of the TAA clarify when and how excess tax may be transferred. Prior to these rules, transfers were governed by administrative policy.

Tax paid in excess by or on behalf of a taxpayer may be transferred only if the tax is refundable and has not already been used to satisfy a tax liability. This means that an offset is not available to the extent that excess tax has been retained by the CIR to meet an outstanding tax liability [s RB 4], or there are insufficient credits available in the company’s ICA [ss RM 13, RM 14].

For tax administration purposes, tax transferred by the transferor is treated as a refund to the transferor on the date of transfer; and tax transferred to the transferee is treated as tax paid by the transferee on the date of transfer (but not for the purpose of imposing shortfall penalties). The transferor and the transferee may be the same person if the transfer is to another tax period or tax type of that taxpayer.

“Tax” includes all taxes, levies and duties. The definition, for transfer purposes, specifically includes financial support, student loan repayment obligations and rebates for childcare and charitable donations [TAA, s 3(1)]. The transfer of excess child support payments is prohibited by s 173U of the TAA, but excess payments of other taxes may be transferred to meet child support obligations.

The rules in Part 10B apply to:

(a) Excess tax paid in the 2002-2003 and future income years;
(b) Excess tax paid in an earlier year if the excess arises between 1 April 2002 and 17 October 2002, if the taxpayer notifies Inland Revenue that Part 10B should apply;
(c) Excess tax paid in an earlier year if the excess arises on an assessment made after 17 October 2002;
(d) Refunds in relation to child care and charitable donations rebates claimed after 17 October 2002;
(e) GST supplies made on or after 1 April 2002;
(f) Tax deducted on behalf of another taxpayer that is paid on or after 1 April 2002; and
(g) Dividend withholding payments and duties paid on or after 1 April 2002.

See TIB vol 14:11 (November 2002) at 35-48, for a detailed explanation and examples of the transfer rules.

1215.32 Transfer of excess tax to another period or tax type [TAA, s 173L]

A taxpayer or their agent may request that the CIR transfer all or part of any excess tax paid to another tax period or to another tax type of the taxpayer. For example, excess provisional tax paid in 20X1 (year 1) may be transferred to pay provisional tax for 20X2 (year 2), or it may be used to meet a GST or FBT liability.
Refunds and Transfer of Excess Tax

The taxpayer may choose the date on which the excess is transferred. In the case of a GST refund, the date may be any day after the end of the GST return period in which the refund arose. In the case of tax deducted on the taxpayer’s behalf (eg PAYE, RWT), the date may be any day after the end of the accounting year in which the deduction occurred. In the case of a tax credit for research and development the date is any day after the end of the accounting year to which the credit relates. In all other cases (eg provisional tax), the date may be any day on or after the date the excess tax is paid.

In relation to excess tax deducted on the taxpayer’s behalf or a tax credit for expenditure on research and development, a taxpayer who has an early balance date may only choose a day after the end of the year in which the deduction occurred or the end of the tax year to which the credit relates.

The ability to elect the date of transfer enables taxpayers to choose a date that is most advantageous to them.

**Example:**
In September 20X2, Alex is assessed in relation to her 20X1-X2 income year and discovers that she has overpaid her tax. She has in the meantime paid her first provisional tax instalment for the 20X1-X2 year on 7 July 20X1, using the standard uplift method. However, she is now concerned that that amount will not be sufficient and a UOMI liability will arise. Alex asks Inland Revenue to transfer the excess as at 7 July 20X1, which it does. The transfer is made from tax overpaid as at the third instalment date. Accordingly, Alex has no UOMI liability on the 7 July 20X1 instalment date.

1215.34 Transfer of excess tax to another taxpayer [TAA, s 173M]

A taxpayer or their agent may request the CIR to transfer all or part of any excess tax paid to another taxpayer. The taxpayer may choose the date on which the excess is transferred as if the transfer were to another tax type or tax period of the taxpayer [see 1215.32], if the transfer is to:

(a) Another company in the same group of companies;
(b) A shareholder-employee of the taxpayer;
(c) A company in which the taxpayer is a shareholder-employee;
(d) A partner in the same partnership;
(e) A relative;
(f) A trustee of a family trust of which the taxpayer is a beneficiary (and vice versa); or
(g) A tax pooling intermediary’s tax pooling account.

If the transfer is to a tax pooling intermediary’s tax pooling account, the date of transfer must be a date that occurs on or after the date of the request.

If the transfer is to a person not listed above, the date of transfer chosen by the taxpayer must be no earlier than the later of:

(a) The date of the request; and
(b) The day after the date the relevant return is filed for the period in which the excess arose.

“Family trust” means a trust that is established primarily to benefit:

(a) A natural person for whom the settlor has natural love and affection;
(b) An organisation or a trust whose income is exempt under ss CW 34 or CW 35; or
(c) A combination of (a) and (b).

“Relative” means another person connected with the first person by blood relationship, marriage, civil union, de facto relationship or adoption. Persons are connected by blood relationship if one is the child of the other. Persons are connected by marriage, civil union or de facto relationship if one is in a marriage, civil union or de facto relationship with the other. Persons are connected by adoption if one has been adopted as the child of the other.

**Example:**
Company A, which has a standard balance date, estimates its provisional tax and pays $120,000 at each instalment date for the 20X1-X2 income year. In May 20X2 Company A files its return, which shows RIT is $300,000 for the year. It has therefore...
Refunds and Transfer of Excess Tax

overpaid tax of $20,000 at each instalment date. Company B is in the same group of companies as Company A. Company B underestimated its first provisional tax instalment on 7 July 20X1 by $20,000 and has incurred UOMI on the underpayment. Company A therefore requests Inland Revenue to transfer the $20,000 excess tax it paid on 7 July 20X1 to Company B as at that date. Company A has no outstanding tax liability, and its imputation credit account has sufficient credits, so Inland Revenue action the transfer at the date requested. The amount transferred is treated as a refund to Company A. It therefore records a debit of $20,000 in its imputation credit account as at 7 July 20X1. The amount transferred is tax paid by Company B, which records a credit in its imputation credit account as at 7 July 20X1. UOMI that has accrued in relation to Company B’s underpayment is cancelled.

1215.35 Limit on transfer by PAYE intermediary [TAA, s 173MB]
Interest paid by the CIR on a payment made by a PAYE intermediary, in their role as an intermediary, to the CIR may not be:
(a) Treated as tax overpaid by the intermediary other than as an intermediary for an employer; and
(b) Transferred to the intermediary in another capacity or to another taxpayer.

1215.36 Transfer of tax credits [TAA, s 173N]
If a taxpayer makes a request to transfer a housekeeping or charitable donations tax credit, the taxpayer may not choose a date earlier than the later of:
(a) The date of the request; and
(b) The day after the date the taxpayer applies for a tax credit.

Example:
Mrs B makes a charitable donation in the 20X1-20X2 year and claims a refund in December 20X2. Her husband underpaid his provisional tax on 7 July 20X2. Mrs B requests in a letter attached to the claim form that the refund be transferred to her husband as at 7 July 20X2, in order to minimize UOMI on the underpayment. Inland Revenue will transfer the excess only as at December 20X2, the date Mrs B claims the refund and makes the transfer request.

1215.38 Transfer of excess tax if no date specified by taxpayer [TAA, s 173O]
If a taxpayer requests a transfer of excess tax but does not specify a date, the CIR will transfer the tax on a date the CIR considers appropriate. The CIR will choose a date that minimises the UOMI impact on the taxpayer. Despite this, the taxpayer may subsequently choose an alternative date allowed under ss 173L and 173M [see 1215.32].

1215.40 Transfer of excess provisional tax before assessment [TAA, s 173P]
If a taxpayer requests a transfer of overpaid provisional tax for a tax year before an assessment has been made for that tax year, the amount of excess provisional tax that may be transferred on a particular date (date A) is calculated using the formula:

\[
\text{provisional tax paid} - \text{refunds} - \text{provisional tax liability}
\]

Where:
“Provisional tax paid” is the provisional tax paid for a tax year on or before date A, including voluntary payments under s RC 12 and tax transferred to the taxpayer;
“Refunds” are the refunds of the provisional tax that are paid to the taxpayer on or before date A, including transfers by the taxpayer or offsets by the CIR against unpaid tax;
“Provisional tax liability” is the provisional tax payable by date A.

The CIR must not transfer an amount on date A if, as a result of the transfer, the taxpayer would not satisfy their provisional tax liability on a subsequent date (date B) before the transfer is actioned. However, the CIR may make such a transfer if the taxpayer later requests a transfer back to satisfy their provisional tax liability on date B.
Refunds and Transfer of Excess Tax

Example:
H pays provisional tax on the uplift basis and is required to pay $50,000 at each instalment. She pays $150,000 at P1. After P2 and before P3, H calls Inland Revenue and requests a transfer of $100,000 at P1 to meet another tax obligation. As at P1, H has overpaid her provisional tax by $100,000 ($150,000 \(\text{−} 0 = $50,000\), as per the formula). However, the restriction applies to limit the amount that may be transferred at P1. If the CIR transfers $100,000 at P1, the provisional tax due at P2 will be underpaid. The maximum that could be transferred at this time is $50,000. The CIR could transfer the whole $100,000 only if $50,000 is transferred back in time to meet the P3 liability.

1215.42 Transfer of excess provisional tax before assessment where estimation method used [TAA, s 173Q]

If a taxpayer, who overpays their provisional tax for the year as a result of changing to the estimation method during the year or of revising their estimate of RIT during the year, requests a transfer of that overpaid provisional tax before an assessment has been made for that tax year, the amount of excess provisional tax that may be transferred on a particular date (date A) is calculated using the formula:

\[\text{provisional tax paid} - \text{refunds} - \text{estimated RIT}\]

Where:
“Provisional tax paid” is the provisional tax paid for a tax year on or before date A, including voluntary payments under s RC 12 and tax transferred to the taxpayer;
“Refunds” are the refunds of the provisional tax that are paid to the taxpayer on or before date A, including transfers by the taxpayer or offsets by the CIR against unpaid tax;
“Estimated RIT” is the taxpayer’s estimated RIT or revised estimated RIT that would be due by date A for the purposes of the interest rules [see 1110.305].

The CIR must not transfer an amount on date A if, as a result of the transfer:
(a) A taxpayer who has revised their estimate of RIT would not have paid the amount of their re-estimated RIT due on date B (a date falling after date A); or
(b) A taxpayer who has changed from the uplift method to the estimation method of calculating their provisional tax would not have paid the amount of their estimated RIT due on date B (a date falling after date A),

unless the taxpayer requests a transfer back to satisfy their provisional tax liability on date B.

The amount that may be transferred under s 173Q of the TAA is limited to the net provisional tax paid less the re-estimated RIT for the tax year (where the taxpayer has revised their estimated RIT), or the net provisional tax paid less the estimated RIT for the tax year (where the taxpayer has changed from the uplift method to the estimation method). Net provisional tax paid is provisional tax paid less any refunds of that tax.

Example:
Neil estimates RIT at $150,000 for the year and pays $50,000 at each of P1 and P2. At P3, Neil revises his estimate to $75,000 and pays no further provisional tax for the year. After P3, Neil applies to transfer the excess provisional tax at the earliest date available. Because the amount of provisional tax paid ($100,000) exceeds the re-estimated RIT ($75,000), the excess would be refundable under s RC 9. The amount of $25,000 can therefore be transferred under s 173Q of the TAA. The earliest date at which the $25,000 can be transferred is P1. The formula would calculate $50,000 as being available at P2, but the amount available to transfer is limited to the difference between net provisional tax paid and re-estimated RIT (ie $100,000 − $75,000 = $25,000).

1215.44 Transfer of excess provisional tax after assessment [TAA, s 173R]

If a taxpayer requests a transfer of excess provisional tax paid after an assessment has been made for that tax year, the amount of excess provisional tax that may be transferred on a particular date (date A) is calculated using the formula:

\[\text{provisional tax paid} - \text{refunds} - \text{residual income tax}\]

Where:
“Provisional tax paid” is the provisional tax paid for the tax year on or before date A, including voluntary payments under s RC 12 and tax transferred to the taxpayer;

“Refunds” are the refunds of the provisional tax that are paid to the taxpayer on or before date A, including transfers by the taxpayer or offsets by the CIR against unpaid tax;

“Residual income tax” is the taxpayer’s RIT that would be due by date A.

The CIR must not transfer an amount on date A if, as a result, the taxpayer would be liable for interest on unpaid tax or would have a late payment penalty imposed in respect of their provisional tax payments on a date (date B) that falls after date A. However, the CIR may make such a transfer if the taxpayer later requests a transfer back, so as to prevent interest or a late payment penalty being imposed on date B.

The amount that may be transferred may not be more than the net provisional tax paid for the tax year less the RIT for the year. Net provisional tax paid is provisional tax paid less refunds.

Example:
Harry pays provisional tax on the uplift basis, but he is subject to UOMI. He paid his provisional tax liability of $20,000 on P1, missed the payment due on P2, and paid $20,000 on P3. His RIT (as per the assessment) is $15,000. The total excess that may be transferred is $25,000 (tax paid of $40,000 less RIT of $15,000). Harry wants to transfer the excess at the earliest possible dates. At P1, the formula calculates an amount available of $15,000. However, if $15,000 were transferred the taxpayer would be liable for late payment penalties and interest at P2. Therefore only $10,000 is transferable at P1. (The additional $5,000 could be transferred provided it was transferred back by P2.) The balance of $15,000 of the excess can be transferred at P3.

1215.46 Transfer of interest on overpaid tax [TAA, s 173S]
If the CIR is liable to pay interest to a taxpayer for an overpayment of tax, the taxpayer or their agent can request the CIR to transfer all or part of that interest to another period, tax type or taxpayer.

The interest is transferred on the date it would have been payable to the taxpayer in the absence of a transfer request.

1215.48 Date of application of excess tax to unsatisfied tax liability [TAA, s 173T]
If the CIR applies excess tax in satisfaction of tax or another amount due by a taxpayer, the taxpayer or their agent may request the CIR to apply that excess on a date allowed by s 173L of the TAA [see 1215.32].
Chapter 1220
Rent

1220.10 Net rental income [s CC 1]
Rent received is income. It is provisional income. Improvements effected by a tenant are neither taxable to
the lessor as rent nor deductible by the tenant. Where a lessee who has agreed to pay the revenue outgoings
on the leased property makes default in the payment, any amounts paid by the lessor may be deducted to the
extent to which they are not recovered from the lessee.

TaxNote: Rental income derived offshore by a transitional resident is exempt from tax. No deductions are
able to be taken against this income [see 370.35].

Where a taxpayer occupies a rented private dwelling-house and a portion of that house is used for business
purposes, a proportionate part of the rent may be claimed as a business expense.

Where property has been purchased for the purpose of reselling, any profit from rental income is taxable.
Expenses such as rates, insurance, and repairs incurred pending sale are deductible from the gross rentals.
Expenses applicable to the property are deductible even though the property may be temporarily vacant.
Where property of an estate is held for letting at an adequate rental with a view to subsequent realisation, the
expenses are allowable to the extent to which they are incurred primarily for the purpose of earning rental
income during the period. Expenditure incurred primarily for the improvement of the property is not
deductible.

(PC) the Privy Council found that a lump sum inducement payment received by an accounting firm for moving
into new premises was not taxable.

(1) Lease for life

A common tax-planning arrangement involves a person granting a “lease for life” to themselves and then
transferring the balance of the property to another person or to a trust. There are various other permutations
that achieve largely the sale result. These transactions are generally undertaken for less than market value.
Whether or not an income tax liability arises depends on how the arrangement is structured. A number of
public binding rulings have been issued which set out the income tax and gift duty consequences of such
arrangements.

All of the following rulings apply from 1 April 2005 for an indefinite period and are set out in TIB vol 17:5
(June-July 2005) at 3-30:

(a) A transferor grants a life estate (including a lease for life) to themselves, and then subsequently
transfers the balance of the property to another person. The retention of the life estate (including a
lease for life) does not give rise to income to the transferor or the transferee under s CC 1(1). The
life estate (including a lease for life) granted by the transferor is a retention and not a reservation for
the purposes of s 70(2) of the EGDA 1968 [see BR Pub 05/02].

(b) A transferor grants a lease for a term to themselves, and then subsequently transfers the balance of
the property to another person. The retention of the lease does not give rise to income to the transferor
or the transferee under s CC 1(1). The lease granted by the transferor is a retention and not a reservation for the purposes of s 70(2) of the EGDA 1968 [see BR Pub 05/03].

(c) A transferor transfers property to another person and, under the arrangement, the other person subsequently grants a life estate (including a lease for life) back to the transferor out of the property transferred. The life estate (including a lease for life) granted back to the transferor is not a lease for the purposes of s CC 1(1)(a), and the grant back of the life estate (including a lease for life) does not give rise to income to the transferor or the transferee under s CC 1(1). The life estate (including a lease for life) granted back to the transferor is a reservation for the purposes of s 70(2) of the EGDA 1968 [see BR Pub 05/04].

(d) A transferor transfers property to another person and under the arrangement the other person subsequently grants a lease for a term back to the transferor out of the property transferred. The transferor either reduces the price of the property first transferred or reduces a debt owed by the transferee to the transferor; or the transferor otherwise pays the transferee. The amount of the reduction in price, reduction in the debt or the payment is attributable to the lease granted back to the transferor. The amount of the reduction in price, reduction in the debt or the payment is income to the transferee under s CC 1(1). The grant of the lease does not give rise to income to the transferor under s CC 1(1). The lease granted back to the transferor is a reservation for the purposes of s 70(2) of the EGDA 1968 [see BR Pub 05/05].

(e) A transferor transfers property to another person and, under the arrangement, the other person subsequently grants a licence back to the transferor out of the property transferred. The transferor either reduces the price of the property first transferred or reduces a debt owed by the transferee to the transferor; or the transferor otherwise pays the transferee. The amount of the reduction in price, reduction in the debt or the payment is attributable to the licence granted back to the transferor. The amount of the reduction in price, reduction in the debt or the payment is income to the transferee under s CC 1(1). The grant of the licence does not give rise to income to the transferor under s CC 1(1). The licence granted back to the transferor is a reservation for the purposes of s 70(2) of the EGDA 1968 [see BR Pub 05/06].

(f) The transferor purports to grant to themselves a licence to occupy; and then purports to transfer the balance of the property to another person; and the transferee then grants a licence back to the transferor. As a transferor cannot legally grant themselves a licence to occupy, the full property interest will be transferred to the transferee. The grant of the licence does not give rise to income to the transferor under s CC 1(1). The licence granted back to the transferor is not a reservation for the purposes of s 70(2) of the EGDA 1968 [see BR Pub 05/07].

(g) A transferor grants themselves a life estate (including a lease for life) and simultaneously transfers the balance of the property to another person. A simultaneous transfer includes the situation where it is the intention of the transferor that only the balance or interest in reversion in the property is transferred (even though, in conveyancing law terms, the whole property initially transfers) and there is an immediate equitable obligation on the transferee to grant back the life estate (including a lease for life). The transferor does not obtain any benefit out of the balance or interest in reversion that was transferred; and the transferor’s intention to retain the life estate (including a lease for life) is evidenced in the documents and in the surrounding circumstances. The retention of the life estate (including a lease for life) does not give rise to income to the transferor or the transferee under s CC 1(1). The life estate (including a lease for life) granted by the transferor is a retention and not a reservation for the purposes of s 70(2) of the EGDA 1968 [see BR Pub 05/08].

(h) A transferor grants themselves a lease for a term and simultaneously transfers the balance of the property to another person. A simultaneous transfer includes the situation where it is the intention of the transferor that only the balance or interest in reversion in the property is transferred (even though, in conveyancing law terms, the whole property initially transfers) and there is an immediate equitable obligation on the transferee to grant the lease back. The transferor does not obtain any benefit out of the balance or interest in reversion that was transferred; and the transferor’s intention to retain the
lease is evidenced in the documents and in the surrounding circumstances. The retention of the lease does not give rise to income to the transferor or the transferee under s CC 1(1). The lease granted by the transferor is a retention and not a reservation for the purposes of s 70(2) of the EGDA 1968 [see BR Pub 05/09].

(i) The transferor purports to grant to themselves a licence to occupy; and simultaneously purports to transfer the balance of the property to another person. The transferee grants a licence back to the transferor. A simultaneous transfer includes the situation where it is the intention of the transferor that only the balance or interest in reversion in the property is transferred even though, in conveyancing law terms, the whole property initially transfers; and there is an immediate equitable obligation on the transferee to grant the licence back. The transferor does not obtain any benefit out of the balance or interest in reversion that was transferred; and the transferor’s intention to retain the licence is evidenced in the documents and in the surrounding circumstances. As a transferor cannot legally grant themselves a licence to occupy, the full property interest will be transferred to the transferee. The grant of the licence does not give rise to income to the transferor or the transferee under s CC 1(1). The licence granted back to the transferor is not a reservation for the purposes of s 70(2) of the EGDA 1968 [see BR Pub 05/010].

1220.20 Rental expenses from own-your-own flat or office

Taxpayers can claim expenses if they occupy an “own-your-own” office or derive income from letting an “own-your-own” office or flat. Usually, the company which has been formed to own the building levies its shareholders for their share of the rates, insurance, maintenance, and other outgoings.

1220.30 Property leased for inadequate rent [s GC 5]

Where property is leased for an inadequate rent, or the lease makes no provision for payment of rent, the CIR may determine what is an adequate rent for that property and the amount is deemed to be income derived by the lessor. The term "property" includes both real and personal property. The provision applies where the property is leased by:

(a) A company to any person;
(b) A person to a relative of the person, or to a related company;
(c) Two or more persons to a relative of any of those persons or to a related company; or
(d) A partnership to a relative of a partner or to a related company.

The term “relative” has its normal meaning and includes a trustee for a relative [see 70 ASSOCIATED PERSONS AND RELATIVES].

The provisions apply only if, and to the extent to which, the property is used by the lessee in the production of income. It has no application to a property used by the lessee as a private dwelling unless the dwelling is used partly for business.

An amount of rent deemed by the CIR to be payable by a lessee to a lessor under s GC 5 is also deemed to be expenditure incurred by the lessee under s DA 1 [see Public ruling BR Pub 06/01 in TIB vol 18.5 (June 2006) at 30-34].

1220.40 Rental losses

Often a property is used for both private enjoyment and the derivation of rental income. The rental income is taxable. The amount of the expenditure applicable to deriving income is deductible. If an overall loss arises, it is deductible against other income. Any expenditure of a capital or private nature is not deductible.

Example:

Assume that a rental property is let for nine months and also used for the private enjoyment of the owner for three months of a year. In nine months there is rental income of $5,000 which is taxable. There was expenditure and depreciation related to the property of $20,000 for the full year. If an apportionment based upon income usage and private usage was appropriate in the circumstances, 9/12 would be deductible and 3/12 not deductible. The calculations would show:

(a) Income:

Example:

Assume that a rental property is let for nine months and also used for the private enjoyment of the owner for three months of a year. In nine months there is rental income of $5,000 which is taxable. There was expenditure and depreciation related to the property of $20,000 for the full year. If an apportionment based upon income usage and private usage was appropriate in the circumstances, 9/12 would be deductible and 3/12 not deductible. The calculations would show:

(a) Income:
Rents received | $5,000
---|---
Less deductible expenditure and depreciation | $15,000
\[ \frac{9}{12} \times 20,000 \]
Loss (either offset against other income or carried forward to a later year) | $10,000
\[ \frac{3}{12} \times 20,000 \]
(b) Private portion:
Expenditure and depreciation | $5,000
\[ \frac{3}{12} \times 20,000 \]

The $5,000 private portion cannot be offset against other income or carried forward.

In TIB vol 4:11 (June 1993) at 7, a question was asked about the availability of a rental loss for offset against other income. The CIR indicated that any rental losses that a taxpayer incurs while absent from New Zealand are available for offset against other income. This is a change from the CIR’s previous policy that saw the CIR unsuccessfully taking before the TRA a number of cases involving rental losses offset against other income.

1220.50 **Lease surrender payments received by a landlord** [ss CB 1, CC 1]

Receipt of a lease surrender payment by a landlord (who is in the business of leasing property) is assessable income under s CB 1. Where the landlord is not in the business of leasing property, but the lease agreement provides for a lease surrender payment, receipt of a lease surrender payment is lease income under s CC 1(1) or (2).

Public ruling BR Pub 09/06 provides that receipt of a lease surrender payment will be capital in nature and not income where the surrender of the lease is of such significance to the business that it constitutes a loss of a structural asset [see TIB vol 21:6 (August 2009) at 37-46]. Whether the lease is of “such significance” is a matter of fact and degree to be determined in the particular circumstances of each case.

Public ruling BR Pub 09/06 does not cover circumstances where the leasing activity carried on by the landlord is not sufficient to constitute a business. However, the commentary on the ruling states that a lease surrender payment in those circumstances may be income on some other basis (ie an amount that arose from an adventure in the nature of trade). Equally, the receipt could be a normal incident of some other business activity and thus a revenue receipt.

1220.55 **Deductibility of loan break fees paid by landlord**

The CIR has issued two public binding rulings covering the deductibility of break fees paid by a landlord. BR Pub 09/09 relates to break fees paid to exit early from a fixed interest rate loan. BR Pub 09/10 relates to break fees paid by a landlord to vary the interest rate of an existing fixed interest rate loan.

(1) **BR Pub 09/09 (early exit)**

Public binding ruling BR Pub 09/09 applies to a fixed interest rate loan used to acquire property to derive rental income. It also applies to a loan that is used to refinance another loan that was used for that purpose. In both cases, the ruling relates to the payment of a break fee paid by the taxpayer to the lender in order to repay and terminate the loan earlier than the agreed repayment date. It makes no difference whether or not the loan is replaced by a further loan from the same or a different lender. The ruling does not apply if the loan is not used solely for the derivation of rental income or if it is part of, or connected with, one or more other financial arrangements between the lender and the borrower. Nor does it apply where the taxpayer has adopted the IFRS financial reporting method [see 470.67].

Under the ruling, the tax treatment is as follows:

(a) A base price adjustment (BPA) must be performed on the termination of the loan;
(b) The amount of the break fee is included in “consideration” in the BPA formula [see 470.80];
(c) A negative result from the BPA formula will be expenditure incurred under the financial arrangement and will be interest;
(d) An automatic deduction for this interest is available to companies other than qualifying companies under s DB 7;
(e) A deduction is available to other taxpayers under s DB 6 provided that the general permission is satisfied; and
(f) If the money was borrowed to purchase a property from which rental income is derived, the general permission will be satisfied.

The ruling applies for the 2008-2009 income year to the 2011-2012 income year.

(2) BR Pub 09/10 (interest rate variation)
Public binding ruling BR Pub 09/10 applies to a fixed interest rate loan used to acquire property to derive rental income. It also applies to a loan that is used to refinance another loan that was used for that purpose. In both cases, the ruling relates to the payment of a break fee paid by the taxpayer to the lender in order to vary the interest rate payable under the loan. The ruling does not apply if the loan is not solely used for the derivation of rental income or if it is part of, or connected with, one or more other financial arrangements between the lender and the borrower. Nor does it apply where the taxpayer has adopted the IFRS financial reporting method [see 470.67].

Under the ruling, the tax treatment is as follows:
(a) No base price adjustment is required at the time at which the rate variation occurs;
(b) Taxpayers who are not cash basis persons, or who are cash basis persons but have chosen to apply a spreading method to the loan, will be required to apply Determination G25 in relation to the variation, which will result in the break fee being spread over the term of the loan;
(c) Cash basis persons will obtain a deduction for the break fee when it is incurred provided that the money was used to purchase a property from which rental income is derived.

The ruling applies for the 2008-2009 income year to the 2011-2012 income year.

(3) BR Pub 10/20 (break fee paid on sale of rental property)
Public binding ruling BR Pub 10/20 applies to the deductibility of a break fee paid by a landlord to exit early from a fixed interest loan on the sale of a rental property. The ruling applies where a person used a fixed interest rate loan to acquire a property from which rental income is derived and, subsequently, in order to sell the property, a break fee is paid to the lender to enable the loan to repaid in full and terminated earlier than its agreed repayment date. The ruling does not apply where:
• The loan is not used solely in the derivation of rental income;
• The loan is part of or connected with one or more other financial arrangements entered into with the same lender; or
• The taxpayer has adopted the IFRS financial reporting method in s EW 15D of the Act [see 470.67]

The ruling provides that a base price adjustment [see 470.80] is required in the income year in which the loan is repaid. The amount of the break fee included in “consideration” in the base price adjustment calculation and will, therefore, increase the size of the negative figure that results from the calculation. The amount of a negative result from a base price adjustment calculation is deemed to be interest under the financial arrangement rules. An automatic deduction is available for companies (other than qualifying companies) under s DB 7 of the Act. For other taxpayers, the amount will be deductible under ss DB 6 and DA 1 (the general permission). The ruling can be viewed in full on the Inland Revenue website www.ird.govt.nz.

1220.60 Cases
In *Eggers v Commissioner of Inland Revenue* [1988] 2 NZLR 365, (1988) 10 NZTC 5,153 (CA), the Court held the appellant was carrying on the business of farming, the development of the land and leasing all considered as part of a single income earning process to yield current income and future income. There being
no competing uses for any part of the assets, the losses were allowed from the farming activity in total without apportionment.

In *TRA Case L81* (1989) 11 NZTC 1,468, a homestead was used 80 per cent as a boarding house (from which rental was earned) and 20 per cent for private accommodation of the taxpayer during a period pending the use by the taxpayer of the whole residence as the family home. The TRA held that 80 per cent of the outgoings were deductible, whether or not those deductions exceeded rentals received.

In *TRA Case J66* (1987) 9 NZTC 1,393, the taxpayers let out a home acquired by them for investment purposes. The home was occupied by them for one-seventeenth of the year. Sixteen-seventeenths of expenses incurred, which exceeded rental income, were allowed as a deduction from other income.

In *TRA Case J97* (1987) 9 NZTC 1,552, repair costs were incurred in one income year to repair damage sustained to a rental property in earlier income years. As the rental activity had ceased at the time at which the expenditure was incurred, it was not deductible. The TRA found that, in order for expenditure to be deductible, it must have formed part of a continuous income-earning process, or one which had discontinued but was soon to be resumed. It must have been related to income earned at that time or shortly afterwards.
Chapter 1230

Repairs and Maintenance

1230.10 Repairs and maintenance — general rules

No deduction is allowed for the capital cost of plant, and all expenses incurred in placing plant in a revenue earning condition should be capitalised. The initial cost of installing plant and equipment is not allowable as a deduction, even where the expenditure consists mainly of wages paid to employees [see TES 9 (October 2003) 133]: Christchurch Press Co Ltd v Commissioner of Inland Revenue (1993) 15 NZTC 10,206 (HC).

In some circumstances, the cost of removing plant, equipment, and office furniture from one building to another may be allowed as a deduction (eg when a business moves from one location to another).

Section DA 1 (the general permission) allows a deduction for expenses incurred on repairs and maintenance. The amount is, of course, limited to expenditure on assets held for the purpose of deriving income or assets that are part of a business. Section DA 2 denies deductions for capital expenditure. Therefore, a distinction is drawn between capital expenditure (improvement or replacement) and revenue expenditure (repairs and maintenance). The timing of the allowable deduction can be affected by the provisions relating to the “unexpired portion” of expenditure [see 1140 PREPAYMENTS].

The additional cost of effecting improvements to a taxpayer’s business premises, by reason of a decision to keep the premises open whilst the alterations are being made, is capital expenditure, being of the same nature as expenditure on the alterations: Mann Crossman and Paulin Ltd v Inland Revenue Commissioners [1947] 1 All ER 742, (1947) 28 TC 410 (KB).

The CIR’s policy on repairs and maintenance is set out in TIB vol 5:9 (February 1994) at 1-5. The principal features of the policy are as follows:

(a) Expenditure on repairs, maintenance, and alterations must be on revenue account in order for it to be deductible. It must be deductible under the normal deductibility provisions of s DA 1 and avoid the prohibition of capital expenditure in s DA 2(1).

(b) Capital expenditure is not deductible, but it will be subject to the normal depreciation rules.

(c) Expenditure required to maintain an asset in the same condition as when the taxpayer acquired it is on revenue account, and therefore deductible.

(d) The replacement of a capital asset is capital expenditure.

(e) A distinct physical unit which can function on its own is a unit against which the extent of expenditure should be measured.

(f) Expenditure on an asset over and above making good wear and tear will be capital expenditure.

(g) No deduction is available for notional repairs.

1230.20 Repair and renewal

“Repair” is restoration by renewal or replacement of subsidiary parts of the whole. Expenditure of this nature is an allowable deduction if there is sufficient nexus with the derivation of income or the carrying on of a business [see 230.20]. “Renewal” is reconstruction of the entirety (not necessarily the whole, but of...
1230.30 Repairs and Maintenance

substantially the whole subject-matter). Only expenditures on repairs and maintenance are deductible as “repairs”: Auckland Trotting Club (Inc) v Commissioner of Inland Revenue [1968] NZLR 967 (CA).

No deduction is allowed for notional repairs and those costs should be capitalised. A notional repair is an amount arbitrarily assigned to repairs out of the total costs of restoring an asset to its original condition. For example, in TRA Case J92 (1987) 9 NZTC 1,518, a taxpayer chose not to repair and upgrade a farm employee’s dwelling, but instead redesigned and reconstructed the dwelling with the result that expenses incurred were held to be capital in nature and prohibited from deduction [see TES 9 (October 2003) 130].

In Sherlaw v Commissioner of Inland Revenue (1994) 16 NZTC 11,290 (HC), repairs were carried out on an old boat shed. This necessitated removing iron from the roof, drilling holes in the floor and, using a crane to place replacement piles. The work, which resulted in a new roof and a new raised-up floor to accommodate the piles, was held to be repairs: [see TIB vol 6:3 (September 1994) at 22].

Expenditure incurred by the lessee of a building to make the building useable for its commercial purposes by repairing defective parts of the building was held by the TRA to be repairs and not capital expenditure. The repairs involved replacing rotted flooring and covering it with particle board, re-routing defective stormwater drains, replacing rusted metal downpipe with PVC downpipe, and replacing the leaking fibrolite roofing with corrugated iron. There was no element of improvement involved in the work and the repairs did not increase the value of the building: TRA Case T43 (1998) 18 NZTC 8,287.

1230.30 Apportionment of repairs and maintenance on buildings

Architects and accountants may make an apportionment for tax purposes between revenue and capital expenditure on repairs, alterations, renovations, and additions to buildings. Apportionment is contemplated within the wording of ss DA 1 and DA 2 and a deduction is not allowed for an expenditure to the extent to which it is capital in nature: Buckley & Young Ltd v Commissioner of Inland Revenue (1975) 2 NZTC 61,036, (1975) 1 TRNZ 180 (SC); Commissioner of Inland Revenue v Banks [1978] 2 NZLR 472, (1978) 3 NZTC 61,236, (1978) 2 TRNZ 323 (CA).

A building comprises various assets and each category must be considered separately. The first step in any apportionment is to divide the total expenditure into its work category of either:

(a) Ancillary plant: lifts, heating and cooling systems, sprinkler systems.
(b) Internal fixtures: all partitions (except those constructed of brick and concrete) internal doors and internal windows, shelving, fixtures and fittings, lockers.
(c) Building proper: the structure of the building, namely, exterior walls including linings, exterior doors, shop fronts and windows, interior bearer walls, interior fixtures of brick or concrete, foundations, roof, ceilings, floors, ceiling, chimney, drainage, sewerage, stairways, plumbing, water and power supply.

After expenditure has been apportioned between the various assets, it should then be apportioned between revenue expenditure and capital expenditure, having regard to the principles applicable to items coming within that category.

1230.40 Repairs and maintenance to ancillary plant and building proper

Expenditure is of a revenue nature when it is:
(a) Repairs and maintenance of existing equipment; or
(b) Alterations not amounting to significant improvement.

Expenditure is of a capital nature when it is:
(a) Installation of new equipment;
(b) Replacement of a whole new asset; or
(c) Major alterations to the extent that they are an improvement.

For information concerning the depreciation rules applicable to buildings, structures, and building fit-outs [see 250 DEPRECIATION].
1230.50 Repairs and maintenance in specific instances

The following is a list of common types of repairs to buildings and fittings, along with comment on how the expenditures are likely to be treated for income tax purposes.

1. Architects' and consultants' fees
   Capitalise to buildings account and depreciate at building rates.

2. Braces to strengthen a building — structural alteration
   Capitalise to buildings account and depreciate.

3. Building alterations
   Cutting a new doorway is a structural alteration unless it is in the nature of an alteration to inner fixtures. The cost of replacing street and other doors is revenue unless an improved type of door has been fitted (e.g., an old wooden door replaced by steel roller door). The cost of the improvements should be capitalised to the building (e.g., installation of doors where no doors previously existed). Cost of structurally altering windows (e.g., setting windows back at an altered angle) should be included in “building proper”.

4. Building site expenses
   In *TRA Case J26* (1987) 9 NZTC 1,152, mortgage interest and rates expenses were disallowed as a deduction. The expenses were incurred on bare industrial-zoned land purchased for the purpose of erecting a purpose-built building for a future tenant. The expenditure was disallowed because it was incurred to retain a capital asset preliminary to commencing a rental business.

5. Cartage
   This cost follows the allocation of the material carried (e.g., cartage of bricks for structural alterations is capitalised to buildings).

6. Demolitions
   Costs of demolition and accompanying losses on buildings do not form part of the capital cost of new buildings for depreciation purposes. Such costs and losses are capital and should be taken to a non-depreciable account. The cost of clearing a site more properly relates to the cost of the site, and cannot be said to relate to the depreciable cost of the new building erected on that site.

7. Dilapidation and deferred repairs and maintenance
   Dilapidation relates to expenditure incurred on repairs to an asset which are undertaken immediately following, or shortly after, purchase. Work of a major nature to repair dilapidation which occurred during the previous ownership should be capitalised because the work is generally regarded as improving the value of the property for the new owner.

8. Drainage, sewerage
   Drainage and sewerage costs are normally part of the cost of building. New installations and extensions should be capitalised.
(9) **Electrical work**
Expenditures for the installation of heavier mains, switchboards, extensions to wiring, larger switchboards, etc, particularly on the installation of lifts and machinery, are likely to be capital in nature. Fluorescent lights, wiring, etc, are treated as additions to buildings.

(10) **Fire or earthquake precautions**
The cost of bringing a building up to the required fire or earthquake standards (eg by installing fire exits and fire escapes or by carrying out earthquake strengthening), should be capitalised to buildings: TRA Case X26 (2006) 22 NZTC 12,315.

(11) **Fire losses**
Expenditure incurred on fire losses, where the damage necessitates a full replacement of the asset, cannot be regarded as repairs or alterations and is not deductible. Where there is only partial damage to the asset, and repairs are undertaken, the deduction for those repairs should be considered on a case-by-case basis to ensure that no improvements are involved. Insurance proceeds, indemnity charges, or compensation payments received for assets lost, destroyed or damaged are taken into account as disposal proceeds for an asset sold under s EE 48 [see 250.165].

(12) **Foundations**
Except for normal repairs, all costs should be capitalised to buildings.

(13) **Hand basins and toilets**
Cost of installation (plumbing, basins, etc) should be capitalised to buildings.

(14) **Heating systems**
Cost of installation should be capitalised to plant. Where only repairs are carried out, the costs should be charged to revenue. If, when making repairs, the opportunity is taken to effect improvements such as increased capacity, more efficient materials or extension of the system, the expenditure should be capitalised.

(15) **Lawns and levelling**
Cost of laying lawns should be added to land account. No depreciation or loss on abandonment is available.

(16) **Lifts**
The cost of altering a lift to comply with fire precautions, enclosing sides etc, is capital expenditure. Alterations are treated as alterations to building. The cost of replacement of the lift by a ramp would be a structural alteration.

(17) **Murals**
In general, murals would fall within the definition of “inner partitions”. The cost should be capitalised and depreciation claimed.

(18) **Parapets**
The initial cost of coating with bitumen, etc to prevent leaks can be capitalised to building account. If water seeps through due to fair wear and tear, the cost of making good the damage is revenue although a full replacement is likely to be capital expenditure.

(19) **Paths and flagstones**
Capitalise to land account. Normal repairs are deductible.

(20) **Pillars**
Pillars that support the building, roof, ceilings, etc, are part of the main structure. The cost of the means of support substituted for a removed pillar should be capitalised to buildings account (this occurs for instance where a pillar is removed and replaced by a horizontal beam).
(21) **Ramps**
A ramp forms part of the main structure and should be capitalised to buildings account.

(22) **Removal expenses**
Costs of rearranging subdividing walls (not being bearer walls within a building) could be revenue expenditure, depending on the facts. Costs of altering main walls or bearer walls would be structural alterations and capitalised to buildings account.

(23) **Rental property repairs**
In *TRA Case J97* (1987) 9 NZTC 1,552, repair costs were incurred in one income year to repair damage sustained to a rental property in earlier income years. As the renting activity has ceased, the costs were not deductible. To be deductible, the expenditure must be incurred as part of a continuous income-earning process, or one which had discontinued but was soon to be resumed. It must have been related to income earned at that time or shortly afterwards.

(24) **Septic tanks**
Capitalise cost to buildings account.

(25) **Shelter trees (other than farmers)**
Capitalise cost to land account [see 430.125].

(26) **Shop fronts modernisation**
A shop front is generally regarded as being part of the “building proper”.

(27) **Skylights**
Cost should be capitalised to buildings account.

(28) **Strengthening building**
The cost of strengthening a building to carry machinery, including testing, consulting engineer’s fees, etc should be capitalised to building but, in some instances, where it can be shown that the long use of machinery has weakened the structure, the cost may arguably be allowed as a deduction.

(29) **Strongroom**
This is part of the building and the cost should be capitalised.

(30) **Windows**
The following policy is applied:
(a) Construction — capitalise to buildings;
(b) Replacement of damaged window with new window of same type — revenue;
(c) Replacement of wooden framed with metal — this expenditure should be capitalised as it is likely to improve the capital value of the asset, and provide an enduring benefit;
(d) Replacement of fixed types with louvres, etc as for (c) above; and
(e) Removal of windows and making good the walls — capitalise to buildings.

(31) **Windows tinting**
Outside windows are part of the building proper. The original cost of the tinting is capital expenditure. Any subsequent treatment of the same windows would be on revenue account and allowable as a deduction.

(32) **Yard**
Capitalise cost of levelling, sealing, etc, to land account and claim repairs only.
1230.60  **Amounts received for non-compliance with covenant to repair**  
[ss CC 2, DB 22, EI 5, EI 6, YA 1]

A payment received by a taxpayer as indemnity, compensation, or damages for the non-performance by a lessee of an obligation under a lease to maintain the leased land or to make repairs to any improvements on the land is income in the year of receipt. However, s EI 5 allows the taxpayer to elect to spread the income over the year of receipt and up to four years following the year of receipt. The election need not be made when the payment is received. It can be made in each of the years over which the income is spread. Any election must be in writing and must be made no later than the due date for filing the tax return for that income year. The CIR may allow an extension of time for the election.

The right to spread the payment is conditional on the taxpayer continuing to “own” the land in the year into which the income (or part of the income) has been spread. A taxpayer is deemed to “own” land in which that taxpayer has any estate or interest, whether legal or equitable, other than an interest by way of mortgagee. A lessee of land who has given a sub-lease is an “owner” for these purposes. Any balance of the payment which has not previously been allocated is automatically allocated to the fourth income year following the year of receipt.

Under s EI 6, where a taxpayer who has received a payment ceases to “own” the land before the end of the third year following the year of receipt, any balance of the payment which remains unallocated is automatically allocated to the year in which the taxpayer ceases to own the land.

Section DB 22 provides limited relief to the lessor where:

(a) The lessor continues to own the land but ceases to use it for the derivation of income;
(b) The lessor incurs expenditure such as maintenance of the land or repairs and maintenance of the improvements;
(c) The expenditure would have been deductible to the lessor if the land was being used in earning assessable income; and
(d) The expenditure is incurred because of the default of the lessee under a covenant to repair.

The amount of the expenditure incurred by the lessor is deductible up to the smaller of:

(a) The expenditure incurred in the income year; and
(b) The amount received from the defaulting lessee in that income year or spread to that income year under s EI 5 (see above).

This provision, contained in s DB 22, anticipates that the expenditure may be incurred in a later year than that in which the compensation is received, possibly in a year when the property, although still owned by the taxpayer, is not producing income.

1230.70  **Payments made for non-compliance with covenant to repair**  
[ss DB 21, EJ 11]

A lessee may have paid compensation to the landlord for neglecting to carry out repairs and maintenance which was a requirement under the lease. A deduction can be claimed where all of the following circumstances exist:

(a) The taxpayer was, or still is, the lessee of land used in deriving income;
(b) Under the lease the taxpayer is, or was, under an obligation to maintain that land or to make repairs to the improvements on the land;
(c) The taxpayer’s failure to perform that obligation led to the taxpayer becoming liable to pay the lessor a sum of money; and
(d) The sum or part thereof is paid to, or recovered by, the lessor from the taxpayer.

The taxpayer is given a right of election either to claim the whole of the expenditure in the year incurred or to spread back the whole or part of the deduction into one or more of the three years immediately preceding the year of payment provided these were years in which the land was used in the production of income. An
election to spread is irrevocable and must be in writing given to the CIR within the time allowed for furnishing the taxpayer’s return of income for the year in which the payment was made, or within such further time as the CIR in its discretion may allow.
Chapter 1240

Research and Development

1240.10 Scientific research expenditure [s DB 33]

A deduction is allowed for any expense incurred by the taxpayer during the income year for scientific research carried on by the taxpayer to derive assessable income. Expenditure which is capital in nature is not precluded from deduction under the provision unless it relates to an asset that is not created from the scientific research and for which depreciation is allowable, or would have been allowable had proper records been kept. For example, the costs of acquiring or building a laboratory or special plant used for scientific research purposes would not be deductible as they are depreciable. However, the cost of scientific research carried on in the process of inventing a new type of machinery may be deductible.

No deductions are allowed if the CIR considers that incomplete and unsatisfactory records have been kept. The CIR has power to set depreciation rates for any asset used in scientific research for the purpose of deriving income.

1240.20 Research and development [ss DB 34, DB 35]

There is a specific regime for the deductibility of expenditure on research and development. Use of the rules is optional. Taxpayers are able to use the general and specific deductibility rules such as s DA 1 (the general permission) or s DB 33 (scientific research) [see 1240.10] should they so choose.

Under the specific regime, taxpayers are permitted to follow their accounting treatment and claim an immediate deduction for research and development costs after applying the asset recognition criteria contained in Financial Reporting Standard NZ IAS-38: Intangible Assets, or under [5.1], [5.2] or [5.4] of the Financial Reporting Standard No 13 1995 (the old standard). Under NZ IAS-38, expenditure on “research” is always written-off, while expenditure on “development” is written-off until such time as the expenditure has resulted in a valuable asset with sufficiently certain economic benefits. This point is reached when the product or process being developed meets all of the following five asset recognition criteria:

(a) The product or process is clearly defined and the costs attributable to the product or process can be identified separately and measured reliably;

(b) The technical feasibility of the product or process can be demonstrated;

(c) The entity intends to produce and market, or use, the product or process;

(d) The existence of a market for the product or process or its usefulness to the entity, if it is to be used internally, can be demonstrated; and

(e) Adequate resources exist, or their availability can be demonstrated, to complete the project and market or use the product or process.

From the point at which these criteria are met, further development expenditure is capitalised and amortised. NZ IAS-38 defines “research” as:

“original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge or understanding.”

“Development” is defined as:
“the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.”

The rules do not allow the deduction of expenditure that has been expensed for accounting purposes on the basis that the amount is immaterial. It is necessary to first apply the criteria to determine whether the expenditure should be expensed or capitalised. However, taxpayers who have total annual research and development expenditure of $10,000 or less, and who write off the expenditure as immaterial for accounting purposes, can treat the expenditure as not being of a capital nature without applying the criteria contained in NZ IAS-38.

Expenditure incurred in devising a patent is deductible under the same criteria as other research and development expenditure.

Where an asset is used in the research and development project, its cost cannot be deducted if it is an asset to which the depreciation regime applies. However, assets which are created from the research and development expenditure, such as prototypes, are subject to the research and development regime for the expenditure incurred in creating them and are not required to be capitalised and depreciated merely because they may be able to be depreciated.

The immediate deduction for expenditure under the regime is achieved by the deeming of the expenditure to not be of a capital nature. However, in order to be deductible, the expenditure must meet the other normal tests of deductibility. This means that the expenditure must have been incurred and it must have the necessary nexus with the income earning process.

Expenditure which has been incurred will not be deductible if the accrual expenditure rules require that it be added back to assessable income [see 1140 PREPAYMENTS].

The normal prohibitions on expenditure of a private or domestic nature apply, as do the prohibitions on expenditure incurred in earning exempt income and income from employment, and expenditure which is otherwise specifically disallowed as a deduction under the ITA 2007. Some research and development expenditure will remain neither deductible nor depreciable (ie “black hole expenditure”) [see TIB vol 13:11 (November 2001) at 30-33].

1240.25 Research and development expenditure deferral regime

Historically, the tax benefit of expenditure incurred on research and development activities has not always been able to be utilised. This is due to the fact that it is often necessary to bring in additional investors when moving to the commercialisation phase. Where the taxpayer is a company, the introduction of new shareholders can result in the company’s losses, which have resulted from the research and development activities, being forfeited. Taxpayers have the option under ss EJ 22 and EJ 23 to either allocate their research and development expenditure to the income year in which it is incurred or to defer the deduction to a later income year.

In order for deferral to be available, the expenditure must be incurred prior to the start of commercial production or commercial use of the product. Expenditure which is able to be deferred is:

(a) Expenditure incurred on research and development;
(b) Depreciation of assets used for research and development; and
(c) Expenditure incurred on market development for a product that has resulted from research and development.

Deferrable expenditure includes a reasonable allocation of overhead expenses such as rent and utility costs. Expenditure on interest is not able to be deferred. To the extent to which the taxpayer decides not to defer the expenditure, it is offset against income in the normal way. Any resulting loss is subject to the normal loss carry-forward rules [see 940.15, 940.18, 940.20].

If the taxpayer decides to defer the deduction, the expenditure must then be offset to the extent possible against income that the person would not have derived but for the research and development having been undertaken or against depreciation recovered on the disposal of an asset used in the research and development.
Research and Development

activities. Deductions from unsuccessful research and development activities can be offset against income from successful projects. The minimum amount that is required to be taken as a deduction in any particular income year is the lesser of the amount of assessable income that would not have been derived but for research and development and the amount of qualifying deductions that have not been allocated to earlier income years. Amounts that have been deferred are also able to be offset against income from another source in any income year to which a loss would have been able to be carried forward from the income year in which the expenditure was incurred.

The maximum amount that is able to be taken as a deduction in any particular income year is the greater of:

(a) The amount of assessable income that would not have been derived in the current income year, but for research and development; and

(b) Deferred expenditure from any earlier income year that satisfies the loss carry-forward rules.

Example:

Innovative Co Ltd is in the process of developing a new product range. After allocating expenses between sales of existing products and sales of new products resulting from research and development activities and also separating out costs of new research and development, the results for the first two years are as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Profit Existing Products</th>
<th>Net Profit New Products</th>
<th>R&amp;D Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1</td>
<td>$700,000</td>
<td>$0</td>
<td>$4,000,000</td>
</tr>
<tr>
<td>20X2</td>
<td>$700,000</td>
<td>$50,000</td>
<td>$0</td>
</tr>
</tbody>
</table>

Year 1: The company decides to defer $3,300,000 of research and development expenditure leaving it in a nil profit situation.

Year 2: The minimum amount that the company must claim as a deduction is $50,000 (being the net profit from the new products). The maximum amount that it can claim is $3,300,000 being previously deferred expenditure. To the extent that the company decides to take a deduction over and above the amount of its profit for the year, the resulting loss will be subject to the loss carry-forward rules in the event of the change in shareholding. To the extent to which the company decides to continue to defer the expenditure, it will be protected from the loss carry-forward rules.

1240.30 Scientific research promoters [s CW 49]

Income derived by any society or association established primarily for the promotion of scientific or industrial research and approved by the Royal Society of New Zealand is exempt from income tax. The exemption applies only if no part of the organisation’s funds is available to be used for the private pecuniary profit of any proprietor, member, or shareholder, including an associate of any proprietor, member, or shareholder.

The exemption does not apply to Crown Research Institutes.

1240.35 Technology development grants and technology transfer vouchers [ss CX 47, DF 1]

(1) Technology development grants

Technology development grants can be made by the Crown to a business to assist with the costs of research and development (R&D). The amount is paid out over the course of the business’s R&D programme. Part of each grant instalment is withheld until the grant administrator is satisfied that the claims made fall within the eligible expenditure criteria under which the grant was approved. The grant administrator is the Ministry of Science and Innovation.

When a grant instalment payment is received (net of the withheld amount), it is treated as excluded income. To the extent to which the payment relates to deductible expenditure, the expenditure is not deductible. To the extent to which it relates to depreciable property, no depreciation is claimable.

Once the conditions of the grant have been satisfied, the retained amounts will be released. If this occurs in a later income year than the one in which the relevant expenditure occurs, the taxpayer has a choice of two ways in which to treat the amount. The first option is to apply the normal provision. If the person’s return of income for the income year in which the expenditure was incurred has already been filed, this would involve filing an amended return. The second option is to treat the amount as assessable income. Where the second option is chosen, no adjustment is required for the expenditure incurred in the prior income year.
Example:

Widget Co Ltd applies for a grant of $1,000,000 for the acquisition and modification of a new manufacturing plant and the cost of staff wages to test the plant and establish operational procedures for it. The grant is approved. In the first income year, Widget Co gradually completes the work and claims the full $1,000,000 in two instalments. Of the expenditure incurred, $800,000 relates to the physical machinery and $200,000 to wages. By the end of the income year, Widget Co has received both instalments of the grant net of a 10 per cent ($100,000) retention pending the provision of audited financial statements to the grant administrator.

The $900,000 grant receipts are excluded income to Widget Co.

Of the $800,000 spent on the plant, $720,000 has been covered by the grant monies actually received. The company can claim depreciation based on the net cost of $80,000.

Of the $200,000 spent on wages, $180,000 has been covered by the grant monies actually received. The company can claim a deduction of the net cost of $20,000.

In the following income year, the company receives the retained amount of $100,000. The company can either:

(a) Treat the amount as excluded income. If it takes this option, it will need to adjust its return of income for the previous income year to eliminate the depreciation claimed for the net cost of the plant and the deduction claimed for wages. If the return has already been filed, this will entail the re-opening of the return.

(b) Treat the amount as assessable income and leave the previous year’s return untouched.

(2) Technology transfer vouchers

Technology transfer vouchers provide for the payment of 50 per cent of the cost of R&D work which a business contracts out to a third party research provider. The grant payments are made direct from the Ministry of Science and Innovation to the research provider.

The taxpayer has two options regarding the tax treatment of these grants. The first option is to ignore the grant for tax purposes, merely claiming a deduction for the half of the expenditure that it incurs itself (assuming that it meets the deductibility criteria in s DB 34). The second option is to treat the grant amount as excluded income. This will still result in a deduction for only half of the expenditure that it incurs itself (assuming that it meets the deductibility criteria in s DB 34).
Chapter 1250
Residence

1250.10 Significance of residence in the imposition of income tax
[ss BD 1(4), (5)]

In the absence of a double tax agreement, the residence of a taxpayer and the country from which income is derived determines whether the income is taxable in New Zealand. The following points summarise the options:

(a) All income derived from New Zealand or foreign sources by any person who is New Zealand resident at the time of deriving the income (including attributed CFC income and foreign investment fund income) is taxable in New Zealand [see 760 INCOME FROM NEW ZEALAND AND FOREIGN SOURCES].

(b) All income which is New Zealand sourced and is derived by a non-resident is liable to New Zealand tax.

(c) Income which is neither New Zealand sourced, nor is derived by a person who is resident in New Zealand at the time the income is derived, is not subject to tax in New Zealand.

<table>
<thead>
<tr>
<th>New Zealand-sourced income</th>
<th>Foreign-sourced income</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Zealand resident</td>
<td>Taxable</td>
</tr>
<tr>
<td>Non-resident</td>
<td>Taxable</td>
</tr>
<tr>
<td></td>
<td>Not taxable</td>
</tr>
</tbody>
</table>

The above table illustrates that for New Zealand residents all income is taxable, whereas for non-residents only New Zealand sourced income is taxable. For an example see TES 19 (September 2004) 267. See Inland Revenue Booklet *New Zealand Tax Residence* (IR292) for further details.

1250.15 Residence

The legislation provides definitions for determining the residence of individuals, companies and trusts. There is no definition for the residence of a partnership.
1250.20  **Residence of individuals** [s YD 1]

The residence of individuals is determined by the length of time a non-resident is in New Zealand or the length of time a resident is out of New Zealand. However, if they have a permanent place of abode in New Zealand they are deemed to be a New Zealand resident irrespective of the number of days absent.

1250.25  **Definition of “New Zealand”**

The definition of “New Zealand” includes not only the continental shelf as defined in s 2 of the Continental Shelf Act 1964, but also the water and air space above any part of the continental shelf to the extent that there is exploration or exploitation of that part or any natural resource of that part, and the exploration or exploitation activities involve or relate to that water or air space [s YA 1, see 760.15].

1250.30  **Permanent place of abode** [s YD 1(2)]

Individuals are residents if they have a permanent place of abode in New Zealand even though they may also have a permanent place of abode outside New Zealand. This may give rise to taxation being assessed in two countries. The position may be clarified by a double tax agreement entered into between the two countries [see 310 DOUBLE TAX AGREEMENTS]. For New Zealand tax purposes there is also a credit given for foreign tax paid.

A permanent place of abode is not defined in the legislation. PIB 118 (November 1982) states that Inland Revenue will consider the following in determining the permanent place of abode:

(a) The length of time spent in New Zealand, and the time spent in other countries prior to, or subsequent to, the time spent in New Zealand;

(b) The domestic situation including the whereabouts of family;

(c) The memberships of professional or trade associations and sports clubs;

(d) Accommodation arrangements;

(e) Home, furniture, vehicles, and contents ownership;

(f) Financial connections, bank accounts, superannuation, insurance;

(g) Other connections associated with the claimed permanent place of abode.

Other factors that have been considered when determining an individual’s permanent place of abode have included:

(a) Employment history and transience of job;

(b) Length of residency in country claimed as permanent place of abode;

(c) Where any sporting, professional and trade ties are retained;

(d) Whether New Zealand or overseas welfare benefits are received;

(e) Whether annual leave is taken in New Zealand or overseas.


In Geothermal Energy New Zealand Ltd it was held irrelevant to the concept of residence that holidays or compassionate leave meant a transitory presence in New Zealand. In Applegate, the Federal Court of Australia had to decide whether a solicitor, who had been asked by the firm which employed him to proceed to Vila for one or two years to establish a branch office there, was “resident” in Australia during his absence. The Court considered s 6(1) of the Australian Income Tax Assessment Act 1936, which defines “resident of Australia” to mean, inter-alia:

“a person, other than a company, who resides in Australia and includes a person:

“(i) Whose domicile is in Australia, unless the Commissioner is satisfied that the permanent place of abode is outside Australia …”
The taxpayer resided in Vila for about 18 months from the end of 1971. It was held that the taxpayer’s only permanent place of abode during the relevant year was in Vila and, therefore, he was not a resident of Australia during that period. It appears from the case that a permanent place of abode does not mean permanent in the sense that the taxpayer intends to live there for the remainder of his life, since that would be equivalent to domicile; and the expression permanent place of abode is something less than domicile. It was also held that as the tax is imposed on an annual basis residency must also be determined on that basis, so that an expressed intention to return to a country at some time in the future is not in itself decisive of the question whether the taxpayer has a permanent place of abode in that country in the particular income year.

Similar sentiments were expressed in *W v Commissioner of Inland Revenue* (1961) 10 MCD 168:

“a home must be regarded as a place to which the characteristics of stability and permanence are attached. It is one’s fixed or settled abode and the place where one’s roots or permanent attachments are to be found … A man may have his home in a particular country although he is not for the time being physically present there.”

A taxpayer will not lose his or her permanent place of abode in a country simply because he or she has not formed an intention to remain indefinitely outside that country: *Federal Commissioner of Taxation v Jenkins* (1982) 12 ATR 745, 82 ATC 4,098 (QSC). In *TRA Case H97* (1986) 10 TRNZ 189, it was held that a permanent place of abode test should be an objective test decided on the relevant facts. See also *TRA Case J98* (1987) 9 NZTC 1,555. Where a taxpayer had requested the New Zealand CIR to assist in completion of a declaration of New Zealand residency for the purpose of obtaining a refund of UK tax on the basis of New Zealand residency, the CIR’s action amounted to a determination of New Zealand residence which bound the taxpayer: *TRA Case J41* (1987) 9 NZTC 1,240. In *TRA Case F138* (1984) 8 TRNZ 140, a university lecturer was overseas for just less than 12 months and always intended to return to New Zealand. It was held that he was a New Zealand resident as his permanent place of abode was New Zealand: *TRA Case F139* (1984) 6 NZTC 60,245 and *TRA Case F150* (1984) 6 NZTC 60,309.

A discussion of the various factors to take into account when determining whether a person has a permanent place of abode in New Zealand is covered in TIB vol 7:1 (July 1995) at 10-12. For examples see TIB vol 11:11 (December 1999) at 13-14 and TES 19 (September 2004) 262, 263.

### 1250.35 Persons coming to New Zealand

A person coming to New Zealand may be deemed to be a resident through being personally present in New Zealand for more than 183 days in the aggregate in any 12-month period. Once this qualifying period has been attained, the person is deemed to be resident from the first day of personal presence. The period of measurement is any 12-month period. It is not any income year or any calendar year.

Presence for part of a day in New Zealand gives rise to deemed personal presence for the whole of that day so that no part of the day is deemed personal absence. This rule applies to both persons coming to New Zealand and persons leaving New Zealand.

In the period from 1 April to the day before arrival, the person is a non-resident and assessed for New Zealand income tax on only New Zealand sourced income. New Zealand sourced non-resident passive income (interest, dividends, or cultural royalties) is assessed with non-resident withholding tax which is deducted at source and is the final tax liability. Other New Zealand sourced income (eg business profits and rents) is subject to tax through the normal assessment procedures.

In the period from the date of arrival to 31 March, the person is assessed with New Zealand income tax on all New Zealand income and overseas income.

#### Example:

Anton arrives in New Zealand on 15 May 20X1 and takes up employment with a New Zealand resident employer. Anton must then provide the employer with a tax code declaration (IR330). The employer makes PAYE tax deductions from Anton’s pay. If Anton is deriving provisional income, the instalments of provisional tax (if any) first fall due in the 20X2-2X3 income year. Terminal tax (if any) for the 20X1-X2 year is also due in the 20X2-X3 income year. If Anton derives income from overseas on or after 15 May 20X1, it is taxable in New Zealand once he has established residence in New Zealand.
For examples see TES 19 (September 2004) 265, 266.

Where non-residents come to New Zealand under the recognised seasonal employment scheme, the person is treated as a non-resident for the duration of their stay in New Zealand. This rule applies from the 2009-2010 income year [s YD 1(11) see 1080.31].

1250.40 Persons leaving New Zealand [s YD 1(5), (6)]

An individual with New Zealand resident status may become a non-resident by being absent from New Zealand for more than 325 days in any 12-month period. However, a resident who leaves New Zealand will not lose New Zealand resident status if a permanent place of abode in New Zealand is retained. If no permanent place of abode is retained in New Zealand, the absence from New Zealand is deemed to commence from the first day of personal absence in the 325-day period.

In the period from 1 April to the day of departure the person is a resident and is assessed with New Zealand income tax on all New Zealand income and overseas income. In the period from the day following departure to the following 31 March, the person is assessed with New Zealand income tax on New Zealand sourced income only. At that point, non-resident passive income from New Zealand (interest, dividends, or cultural royalties) is assessed with non-resident withholding tax which is deducted at source and is the final tax liability. Other New Zealand income (eg business profits and rents) is subject to tax through the normal assessment procedures.

A useful discussion of the factors that are relevant in determining whether a person on a two year overseas working holiday remains a New Zealand resident for tax purposes is covered in TIB vol 11:10 (November 1999) at 34-36. For examples see TES 19 (September 2004) 263, 266.

1250.45 Where overlap exists in the 183 day and 325 day rules

PIB 180 (June 1989) stated that where a person is travelling in and out of New Zealand an overlap between the 183 day and 325 day rules can occur. A person who is resident under the 183 day rule may have been temporarily absent from New Zealand at a time before the end of the counting of the days of presence for the purpose of the 183 day rule. If the person thereafter satisfies the 325 day rule by being absent from New Zealand for more than 325 days in any 12-month period, the person will cease to be resident in New Zealand from the first day of absence in that period (assuming no permanent place of abode) even though that day falls before the final day which is taken into account in determining that the person is resident in New Zealand by virtue of the 183 day rule. Consequently, in this situation the period of absence taken into account for the purpose of the 325 day rule effectively cuts into the period of presence taken into account for the purpose of the 183 day rule. This may result in the person being deemed to be resident for a period of less than 183 days even though he or she was present here for more than 183 days in a 12-month period.

The two rules may also overlap in the converse situation. Thus, a person who ceases to be resident under the 325 day rule may have been temporarily present in New Zealand at a time before the end of the counting of days of absence for the purpose of the 325 day rule. If the person then satisfies the 183 day rule by being present in New Zealand for more than 183 days in any 12-month period, he or she will become resident in New Zealand from the first day of presence in that period even though that day falls before the final day taken into account for the purpose of applying the 325 day rule. This may result in the person being deemed to be non-resident for a period of less than 325 days even though he or she was absent for more than 325 days in aggregate in a 12-month period.

In circumstances where there is an overlap between a period taken into account for the 183 day rule and a period taken into account for the 325 day rule, the later period chronologically operates to confer residence or non-residence respectively from the first day of that period.

Example 1:

Amy departs from New Zealand on 1 May 20X1, returning on 1 January 20X2 after 244 days of absence. She again departs from New Zealand on 1 February 20X2 after 32 days of presence. She returns on 28 April 20X2 after 85 days of absence and remains in New Zealand thereafter. It is assumed that she does not have a permanent place of abode in New Zealand until she returns on 28 April 20X2. It is also assumed that she was resident in New Zealand under the 183 day rule prior to departure on 1 May 20X1.
The result is that Amy ceases to be resident in New Zealand from 2 May 20X1 until 31 December 20X1. She becomes resident in New Zealand again on 1 January 20X2.

Explanation:
(a) Amy is personally absent from New Zealand for 329 days in aggregate in the 12-month period commencing on 2 May 20X1 (ie for 244 days from 2 May 20X1 to 31 December 20X1, and for 85 days from 2 February 20X2 to 27 April 20X2). Amy therefore ceases to be resident in New Zealand from the first day of absence (ie 2 May 20X1).
(b) Amy is personally present in New Zealand for 280 days (ie more than 183 days), in the 12-month period commencing on 1 January 20X2 (ie for 32 days from 1 January 20X2 to 1 February 20X2, and 248 days from 28 April 20X2 to 31 December 20X2). She is resident from the first day of presence in that 12-month period (ie 1 January 20X2).
(c) The period taken into account for the purpose of the 183 day rule cuts into the period taken into account for the purpose of the 325 day rule. Thus, Amy is only non-resident from the commencement of the period of absence (ie 2 May 20X2), until the day before the beginning of the period taken into account for the purpose of the 183 day rule (ie 31 December 20X2).

Example 2: Bill arrives in New Zealand on 1 November 20X1 and remains for 150 days until 30 March 20X2. Bill departs on 30 March 20X2, returning on 5 May 20X2, a period of absence of 35 days (ie from 31 March 20X2 to 4 May 20X2 inclusive). He is present in New Zealand from 5 May 20X2 to 13 June 20X2, a total of 40 days. Bill departs again on 13 June 20X2 and remains outside New Zealand indefinitely. It is assumed that he is resident outside New Zealand before he arrives on 1 November 20X1 and that he does not at any time have a permanent place of abode in New Zealand. The result is that Bill is resident in New Zealand from 1 November 20X1 to 30 March 20X2. He ceases to be resident in New Zealand on 31 March 20X2.

Explanation:
(a) Bill is present in New Zealand for 190 days in aggregate in the 12-month period commencing on 1 November 20X1 (ie for 150 days from 1 November 20X1 to 30 March 20X2, and for 40 days from 5 May 20X2 to 13 June 20X2). He is resident from the first day of presence (ie 1 November 20X1).
(b) Bill is absent from New Zealand for 327 days in aggregate in the 12-month period commencing on 31 March 20X2 (ie for 35 days from 31 March 20X2 until 4 May 20X2, and for 292 days from 12 June 20X2 to 30 March 20X3). He ceases to be resident in New Zealand from the first day of absence (ie 31 March 20X2).
(c) The period taken into account for the purpose of the 325 day rule cuts into the period taken into account for the purpose of the 183 day rule. Consequently, Bill is only resident from the commencement of the period of presence (ie 1 November 20X1), until the day before the beginning of the period taken into account for the purpose of the 325 day rule (ie 30 March 20X2).

1250.50 Government service [s YD 1(7)]

A person (other than a company) who is personally absent from New Zealand in the service in any capacity of the New Zealand Government is deemed to be resident in New Zealand during that absence. The remuneration is liable to New Zealand tax as well as overseas tax. New Zealand will give credit for the overseas tax against the New Zealand tax, but this does not apply if the relevant double tax agreement provides otherwise.

1250.55 University professors on sabbatical leave

When sabbatical leave is taken, study or research is usually undertaken at an overseas university or another approved institution. Salary, however, continues to be paid from New Zealand and the question which arises is whether the salary is liable to New Zealand tax if the period abroad exceeds 325 days under the residency rule. Furthermore, the salary paid is not in recognition of past services but for the continuing employment of the professor and is for work or services performed outside New Zealand.

The test is whether the person has a permanent place of abode in New Zealand, even though that person may also have a permanent place of abode outside New Zealand. Absence on sabbatical leave does not give rise to non-residence if a permanent place of abode is retained in New Zealand.

The home of a university professor whilst on sabbatical leave constituted a permanent place of abode: TRA Case Q55 (1993) 15 NZTC 5,313.

1250.60 Residence of company [ss YD 2, YD 3]

A company is deemed to be resident in New Zealand if:
(a) It is incorporated in New Zealand;
(b) It has its head office in New Zealand;
(c) It has its centre of management in New Zealand; or
(d) Control of the company by its directors, acting in their capacity as directors, is exercised in New Zealand, whether or not decision making by directors is confined to New Zealand.

If a company is not resident in New Zealand it is deemed to be a non-resident company. A foreign company is, for the purposes of the definition of “available subscribed capital” (ASC) and the international tax rules for any accounting period of the foreign company, deemed to be resident in a particular country or territory if at any time during that accounting period the company is liable to income tax in that country by reason of domicile, residence, or place of management in that country or territory, or any other similar criteria.

If there is the possibility of a company being deemed to be resident in more than one country, it is deemed to be resident in a country using the same rules (a) to (d) above as would apply if it were a New Zealand company. Failing that it is deemed to be resident where its centre of management is located. If difficulties still occur, the CIR has power to make a final decision.

Previously, a company’s residency was defined with reference to whether it was incorporated in New Zealand or had its head office in New Zealand. Its head office in New Zealand was taken as meaning the centre of its administrative management, and this could have meant day-to-day management or the highest level of administrative management. In TRA Case N28 (1991) 15 TRNZ 795, the objector was a duly incorporated private company in Papua New Guinea and was a wholly owned subsidiary of a New Zealand based company which was incorporated in New Zealand. However, the company’s physical activities and work were carried out mainly, if not wholly, in PNG as a forestry management operative. It was held that (with reference to the 1985, 1986, and 1987 income years):

(a) The legislation looked more to the centre of the day-to-day activities, the reality of carrying on business or the administrative function to see where the head office of the company was situated.
(b) The administrative management is not the same as management by itself. The focus on the actual place of management is important.
(c) The centre of the objector’s administrative management was at all times in PNG. The actual carrying out of decisions wherever made was executed in PNG. That is where they were administered from, so that was the centre of the objector’s administrative management.
(d) At all material times the objector was not a resident in New Zealand.

Whether the “centre of management” test now deems a particular company which is not registered in New Zealand and has no head office or directors acting in New Zealand as a resident company depends on all the facts in the particular circumstances. The tests are independent and companies incorporated outside New Zealand which were formerly not resident for New Zealand tax purposes may now in many situations be residents. Until case law evolves, many companies may need to take care that there is no centre of management in New Zealand and that all approvals or substantive decisions are made outside New Zealand. For examples see TES 19 (September 2004) 270, 271.

The position was clarified to some extent in New Zealand Forest Products Finance NV v Commissioner of Inland Revenue (1995) 17 NZTC 12,073 (HC). The company in question, a wholly-owned subsidiary of NZFP, was incorporated and registered in the Netherlands Antilles. The board, consisting of three directors, held all its meetings outside New Zealand. One of the directors was also a director of the parent company, NZFP. Although the company’s articles of association gave NZFP the power to remove directors, NZFP did not have the power to direct them how to vote. The company’s shareholder meetings took place in the Netherlands Antilles. The ongoing administration of the company was carried out by a trust company (unconnected with NZFP or its subsidiaries) resident in the Netherlands Antilles. The Court applied the test in De Beers Consolidated Mines Ltd v Howe (Surveyor of Taxes) [1906] AC 455, (1906) 5 TC 198 (HL) and the company was found to be not resident in New Zealand. The following reasons were given for the decision:

(a) All decisions by directors were taken outside New Zealand;
(b) The essential management functions of the company took place outside New Zealand; and
(c) All shareholder meetings took place outside New Zealand.

1250.65 Residence of trusts
The residence of a trust is determined by the residence of its settlor, in that a non-complying trust or a foreign trust is deemed to be a complying trust by virtue of having a New Zealand resident settlor [see 1420 TRUSTS AND ESTATES].

1250.70 Residence of partnerships
There are no tests for the residence of partnerships. As the income or loss of a partnership is transferred to each of the partners for assessment purposes, it follows that the residence of each individual partner determines how income is assessed to each partner.
## Chapter 1260

### Resident Withholding Tax

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1260.05  Overview

Resident withholding tax (RWT) is a tax deducted by the payer from interest, dividends, taxable Maori authority distributions (other than a retirement scheme contribution) and replacement payments under a share-lending arrangement [see 1340.90] paid to New Zealand residents. RWT also applies to interest paid in New Zealand to a fixed establishment of a non-resident. Other payments to non-residents are subject to “non-resident withholding tax” (NRWT) [see 1020 NON-RESIDENT WITHHOLDING TAX]. RWT is not a final tax. RWT deductions are credited against the taxpayer’s year-end tax liability and may be refunded if they exceed the income tax liability for the year.

TaxNote: A rewrite error resulted in interest paid in New Zealand to a fixed establishment of a non-resident not being subject to RWT. The correction applies with effect from the beginning of the 2008-2009 income year. However, where a person not deducted RWT as a result of relying on the legislative error, and that position was taken between 1 April 2008 and 3 December 2009, their position is protected.

RWT does not apply to certain types of interest and dividends [see 1260.30 and 1260.60]. Income that is subject to RWT is referred to collectively as “resident passive income”. The RWT rules do not apply to payments of use of money interest by the CIR. The rate at which RWT is deducted from interest depends on whether or not the recipient is a company, has supplied their tax file number to the payer, and has made an election to apply a particular rate [see 1260.25].

TaxNote: From 1 October 2010 the RWT rates applying to interest are reduced to reflect the new personal tax rates that apply from that date.

Payments of taxable Maori authority distributions are also subject to RWT [see 1260.70]. The normal rate of deduction is 19.5 per cent. However, if the distribution is more than $200 and the Maori authority does not have a record of the tax file number of the recipient, the rate of deduction is 33 per cent.

Also subject to RWT are replacement payments under a share-lending arrangement [see 1260.73]. The rate of deduction is 33 per cent.

RWT is deducted from dividends at the rate of 33 per cent in all cases. If the dividend is a non-cash dividend, the payer must pay to the CIR the amount of RWT that would have been deducted if the dividend had been a cash dividend [see 1260.45]. The amount of RWT payable on dividends is reduced by the amount of any imputation credits or FDP credits attached to the dividend, and by any foreign tax paid in respect of the dividend. If a dividend is fully imputed, no RWT will be payable [see 1260.65].

A person is only liable to deduct RWT from a payment of interest or dividends if:

(a) The person is resident in New Zealand or is carrying on a taxable activity in New Zealand through a fixed establishment; and

(b) One or more of the following applies:

(i) The person does not hold a certificate of exemption;

(ii) The payment is made in the course or furtherance of a taxable activity;

(iii) The payment is a payment of dividends;

(iv) The payment is a taxable Maori authority distribution; or

(v) The payment is a replacement payment under a share-lending arrangement.

Certain categories of taxpayer may apply for a certificate of exemption [see 1260.135]. Amounts paid to a taxpayer holding a certificate of exemption is not required to have RWT deducted from it. However, any resident taxpayer holding a certificate of exemption who makes a payment of resident passive income must deduct RWT from that payment (unless the recipient holds a certificate of exemption).

Deductions of RWT must be paid to Inland Revenue by the 20th of the month following the month of deduction. If RWT deductions from interest are less than $500 per month, those deductions are required to be made only twice a year, on 20 October and 20 April [see 1260.95].
1260.05(1)

\(1\)  \textit{Australian unit trust dividends}

New Zealand fund managers who elect at their option to be an RWT proxy, can withhold RWT from dividends received by New Zealand investors from Australian unit trusts. This saves many such investors from having to file income tax returns [see 1260.10].

\textbf{1260.10 Who deducts and pays RWT} \([\text{ss RE 3, RE 4, RE 5, RE 6}]\)

Section RE 3 requires a person who makes a payment of resident passive income to deduct an amount of RWT in terms of the formulae given in ss RE 12 (interest), RE 13 (dividends other than non-cash dividends), RE 14 (non-cash dividends other than bonus issues), RE 15 (bonus issues in lieu), RE 16 (taxable Maori authority distributions), RE 17 (replacement payments under a share-lending arrangement), and RE 18 (payments made by RWT proxies).

A person is liable to pay RWT to the CIR if the person makes a payment of resident passive income from which a deduction is required.

A person is required to deduct RWT, if at the time of payment of the resident withholding income, that person is either:

(a)  A New Zealand resident; or  

(b)  Not resident in New Zealand, but carrying on taxable activity in New Zealand through a fixed establishment \([\text{s RE 4(2)}]\).

“Taxable activity” has the same definition as in the Goods and Services Tax Act 1985, except that an activity that involves the supply of goods and services for a consideration does not apply \([\text{s YA 1}]\).

“Fixed establishment in New Zealand” is a fixed place of business in which the person carries on a substantial business \([\text{s YA 1}]\).

No person is treated as a resident or as carrying on a taxable activity in New Zealand through a fixed establishment if the payment of interest or dividends is attributable to, or effectively connected with, a fixed establishment of that person outside New Zealand or, in the case of the payment of dividends, the company is not a New Zealand resident; and in either case the payment is made in a currency other than New Zealand currency.

RWT must be deducted if the payer either:

(a)  Holds a certificate of exemption;  

(b)  Makes payments in the course of a taxable activity, including the acting as agent or trustee for any other person;  

(c)  Makes payment of dividends on shares issued by that company;  

(d)  The payment is a taxable Maori authority distribution; or  

(e)  The payment is a replacement payment under a share-lending arrangement.

\textbf{1260.15 RWT Proxy} \([\text{TAA, s 15N}]\)

If a person elects to be an RWT proxy for the payer, the person will also be liable to pay RWT to the CIR in respect of that resident passive income.

The RWT proxy rules were inserted following an amendment to treat certain non-taxable bonus issues of foreign unit trusts (principally targeted at Australian unit trusts) as dividends. The non-taxable bonus issues will be treated as a dividend when the bonus issue is made under an arrangement or decision that the unit trust will make the bonus issue instead of distributing the underlying income through to the unit holder \([\text{s CD 10}]\). Consequently, New Zealand residents in receipt of these dividends will have an income tax liability, with the antecedent obligation to file a return of income (if they are not already doing so) if the requirements of s 33A of the TAA are not met, or are no longer met.

The RWT proxy rules have been designed essentially to allow New Zealand fund managers to account for the RWT as a proxy for non-resident unit trust payers. The rules were designed to make it easier for the ultimate recipient of the non-taxable bonus issue (that is now treated as a dividend) to comply with their

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income tax obligations. However, the rules are not limited to non-taxable bonus issues that are treated as dividends, but extend to all dividends. This is voluntary and done by an election under s 15W of the TAA.

A person (most likely a fund manager, but not necessarily so) can elect to be an RWT proxy for a payer of dividends that are resident passive income if:

(a) The payer of the dividend is a non-resident unit trust;
(b) The recipient of the dividend is a natural person or a trustee of a qualifying trust who has requested the person to act as a proxy in relation to the payment and the person has agreed to the request; and
(c) The payment is made while the election is effective.

The person notifies the CIR of their election to be an RWT proxy in respect of the dividends distributed by the payer (the non-resident unit trust). The notice must contain the election, the person’s name and postal address and the date on which the election takes effect.

The proxy is able to cancel the election at any time by notifying the CIR. The cancellation then takes effect from the later of the date set out in the notification of cancellation or the date on which the CIR receives the notification.

### 1260.20 Disclosure of tax file numbers [TAA, ss 27, 54]

A payer who is required to deduct RWT from a recipient must provide the CIR, for each recipient:

(a) The full name and last known address;
(b) Total resident passive income from which RWT deduction was required to be made by the payer;
(c) The tax file number, if any, of the recipient; and
(d) Any further information the CIR may require.

The CIR has a discretion to exempt persons from any or all of these requirements.

A recipient of resident passive income, from which RWT must be deducted by a payer, and who has a tax file number, must on written request provide the tax file number to the payer within 10 working days.

### 1260.25 Interest [ss RE 12, RE 19; TAA, s 25A]

The rate of RWT on interest is calculated using the following formula:

\[
\text{rate of RWT} = \left( \text{tax rate} \times \left( \text{interest paid} + \text{foreign withholding tax} \right) \right) - \text{foreign withholding tax}
\]

Where:

“Tax rate” is the basic rate in sch 1, Part D, cls 3 or 4 (see below);
“Interest paid” is the amount of interest paid, before deduction of RWT; and
“Foreign withholding tax” is foreign withholding tax (other than New Zealand tax) that is deducted from that interest and is substantially of the same nature as New Zealand NRWT.

The tax rate to be used in the above formula is as follows [see sch 1, Part D, cls 3 or 4]:

From 1 October 2010:

For trustees of a testamentary trust not subject to the minor beneficiary rule, payee’s tax file number 10.50% supplied, and payee elects to apply this rate or, before 1 October 2010, elected the 12.5% rate

For a payee other than a trustee, payee’s tax file number supplied, payee has reasonable expectation 10.50% at time of election that their income for the year will be $14,000 or less and payee elects this rate or, before 1 October 2010, elected the 12.5% rate

Payee’s tax file number supplied, and payee elects to apply this rate or, before 1 October 2010, the 17.50% payee had elected the 19.5% or 21% rate

Payee’s tax file number supplied, the account was opened on or before 31 March 2010, and the 17.50% payee has not elected a rate
Resident Withholding Tax

Payee’s tax file number supplied, and payee elects to apply this rate or, before 1 October 2010, the payee had elected the 33% rate

Payee’s tax file number supplied, and payee elects to apply this rate or, before 1 October 2010, the payee had elected the 38% or 39% rate

For new accounts opened after 31 March 2010, payee’s tax file number supplied but payee has not elected a rate (the “default rate”)

If the payee’s tax file number not supplied (the “no declaration rate”)

The income bands for which the above rates are appropriate are

<table>
<thead>
<tr>
<th>Income band</th>
<th>RWT rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1 - $16,800</td>
<td>10.50%</td>
</tr>
<tr>
<td>$16,801 - $57,600</td>
<td>21%</td>
</tr>
<tr>
<td>$57,601 - $84,000</td>
<td>30%</td>
</tr>
<tr>
<td>$84,001 upwards</td>
<td>33%</td>
</tr>
</tbody>
</table>

A person receiving an interest payment may elect to have RWT deducted at a rate that is higher than their marginal tax rate. By electing a higher optional rate, higher income earners can avoid a large terminal tax payment at the end of the year.

The no declaration rate applies where the payee fails to supply their tax file number to the payer. If the interest is being paid to more than one person, only one tax file number is required.

If the payee is a company (other than a trustee company or a Maori authority), the RWT rate is 28 per cent.

The CIR has the power to require a payer to change the rate applying to a payee where the rate applying by election or default is inconsistent with the person’s marginal rate. Where this occurs, the person remains able to elect a different rate [TAA, s 25A].

The term “interest” includes a redemption payment, which is the amount paid on the redemption of a commercial bill as far as it exceeds the money lent. RWT on interest is deductible from the difference between the original issue price and the redemption price of stock, including Government stock, and not on the difference between the acquisition price, even if bought on the open market, and the redemption value received.

Example:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government stock issue price</td>
<td>$48,000</td>
</tr>
<tr>
<td>Taxpayer later purchases on market</td>
<td>$49,000</td>
</tr>
<tr>
<td>Maturity value paid to taxpayer</td>
<td>$50,000</td>
</tr>
</tbody>
</table>

The RWT for interest on the redemption payment is based on $2,000, although the taxpayer’s gain is only $1,000 on redemption.

For the purposes of the RWT rules, dividends paid by a building society in relation to withdrawable shares, and dividends paid by a friendly society in relation to shares, are deemed to be interest and not dividends.

1260.30 Interest that is not included [s RE 2]

The following interest is not subject to an RWT deduction:

(a) Exempt interest (see below);
(b) Interest derived by a person who holds a certificate of exemption;
(c) Interest that is non-resident passive income;
(d) Interest derived from outside New Zealand by a non-resident;
Resident Withholding Tax

(e) Interest that has a New Zealand source and which is derived by the Cook Islands National Superannuation Fund (as established under s 11(1)(a) of the Cook Islands National Superannuation Act 2000). The reason for this exclusion is that this entity is a non-resident under s YD 2(3);

(f) Interest payable between companies where both companies are, at the time of payment, members of the same group;

(g) Use of money interest payable by a taxpayer under Part 7 of the TAA;

(h) Interest paid to an intermediary by a client in the operation of a tax pooling account [see 1150.77];

(i) Interest paid by the CIR to an intermediary in relation to a tax pooling account [see 1150.77]; and

(j) Interest paid by the CIR under s 120D of the TAA on overpaid tax (applies to interest payments made from 1 April 2005).

Exempt interest includes:

(a) Interest payable on debts made for the purchase of goods or services in the ordinary course of the purchaser’s taxable activity, in accordance with generally accepted commercial practice (ie trade credits);

(b) Interest payable under a hire purchase agreement;

(c) Exempt interest payable out of New Zealand to a non-resident for money lent to the New Zealand Government or (with the approval of Government) where it is lent to a local or public authority for non-commercial activity, or expressly exempted from income tax by any other Act, to the extent of the exemption;

(d) Interest payable under a specified lease or finance lease;

(e) Interest payable on bonus bonds or Post Office bonus bonds;

(f) Interest payable on an overpaid estimated employers account levy; and

(g) Interest payable by the CIR under s 84 of the KiwiSaver Act 2006.

**1260.35 Interest threshold of $5,000** [s RE 10]

An interest threshold applies to a payer of interest without a valid certificate of exemption or who holds a certificate of exemption and has paid interest of less than $5,000 in the year preceding the year of payment. These persons are not required to deduct RWT from payments of resident passive income until such payments, in that year, exceed $5,000.

RWT does not need to be deducted when the payer does not have a presence in New Zealand. The liability to deduct RWT applies only when the payer is:

(a) A New Zealand resident; or

(b) A non-resident but carrying on a taxable activity in New Zealand through a fixed establishment in New Zealand.

The first test is not satisfied by a partnership because a partnership cannot be resident in New Zealand under the residence tests as it is not a separate taxpayer [see PIB 180 (June 1989)]. A partnership is required to deduct RWT if it is caught under the second test, that is, carrying on a taxable activity through a fixed establishment in New Zealand.

**Example:**

Mechanics Partnership carries on a car repair and servicing business. On 1 April 20X1 one of the partners lent the partnership $83,300 at six per cent to enable the partnership to purchase some machinery. He advanced the loan for a five-year term. No loans had been advanced to the partnership in the preceding year. On 31 March 20X2 the partnership paid the partner $5,000 in interest. This was the only interest paid by the partnership for the 20X1-2X2 income year.

On 1 April 20X2 the partner lent the partnership a further $45,000, and another partner also lent the partnership $45,000 at six per cent for five years. On 31 March 20X3 the partnership paid the first partner $7,700 and the second partner $2,700 in interest. The partnership does not have a certificate of exemption. The partners making the loans also do not have certificates of exemption. The partnership must deduct RWT from all the interest paid to the partners on 31 March 20X2 because it paid $5,000 interest in the preceding year (the 20X1-2X2 income year) and in the 20X2-3 income year paid more than $5,000 interest.
The partnership was not required to deduct RWT in the 20X1-X2 income year because it did not have a certificate of exemption, it did not make interest payments in the preceding year (the 20X0-X1 income year), and payments in the 20X1-X2 income year did not exceed $5,000 [see TIB vol 6:5 (November 1994)].

1260.40 **Cash dividends** [s RE 13]
The amount of RWT on dividend resident passive income, but excluding non-cash dividends, is:

\[
(\text{tax rate} \times (\text{dividend paid} + \text{tax paid or credit attached})) - \text{tax paid or credit attached}
\]

Where:

“Tax rate” is 33 per cent [see sch 1, Part D, cl 5];

“Dividend paid” is the amount of dividend paid, before deduction of RWT; and

“Tax paid or credit attached” is the total of the following amounts:

(a) If the dividend is paid in relation to shares issued by an imputation credit account company, the amount of any imputation credit attached to the divided (this includes any trans-Tasman imputation credits when the ICA company maintains an ICA under s OB 2);

(b) If the dividend is paid in relation to shares issued by a company not resident in New Zealand, the amount of foreign withholding tax paid or payable in respect of the amount of the dividend; or

(c) If the dividend is paid in relation to shares issued by a company resident in New Zealand, the amount of any FDP credit attached to the dividend.

1260.45 **Dividends comprising non-cash dividends (but not bonus issues in lieu)** [s RE 14]
The amount of RWT on dividend resident passive income that comprises non-cash dividends (but excluding bonus issue in lieu) is:

\[
\left(\frac{\text{tax rate} \times \text{dividend paid}}{1 - \text{tax rate}}\right) - \text{tax paid or credit attached}
\]

Where:

“Tax rate” is the basic rate set out in sch 1, Part D, cl 5;

“Dividend paid” is the amount of the dividend paid before the amount of tax is determined;

“Tax paid or credit attached” is the total of the following amounts:

(a) If the dividend is paid in relation to shares issued by an ICA company, the amount of an imputation credit attached to the dividend;

(b) If the dividend is paid in relation to shares issued by a company not resident in New Zealand, the amount of foreign withholding tax paid or payable on the amount of dividend;

(c) If the dividend is paid in relation to shares issued by a company resident in New Zealand, the amount of an FDP credit attached to the dividend.

1260.50 **Dividends that comprise bonus issues in lieu** [s RE 15]
The amount of RWT on bonus issues in lieu is:

\[
(\text{tax rate} \times (\text{alternative amount} + \text{tax paid or credit attached})) - \text{tax paid or credit attached.}
\]

Where:

“Tax rate” is the basic rate set out in sch 1, Part D, cl 5;

“Alternative amount” is the amount of money offered as an alternative to the bonus issue before the amount of tax is determined;

“Tax paid or credit attached” is the total of the following amounts:

(a) If the dividend is paid in relation to shares issued by an ICA company, the amount of an imputation credit attached to the dividend;

(b) If the dividend is paid in relation to shares issued by a company not resident in New Zealand, the amount of foreign withholding tax paid or payable on the amount of dividend;
(c) If the dividend is paid in relation to shares issued by a company resident in New Zealand, the amount of an FDP credit attached to the dividend.

1260.55 Dividends and RWT proxies [s RE 18]

A person who is an RWT proxy for a payer of RWT income and a payment of resident passive income in the form of a dividend must pay the amount of RWT given by the formula:

\[
\frac{\text{tax rate} \times \text{amount paid}}{1 - \text{rate}}.
\]

Where:

“Tax rate” is the basic rate set out in sch 1, Part D, cl 2; and

“Amount paid” is the amount of the dividend paid.

1260.60 Dividends which are not included [s RE 2]

The following dividends are excluded from having RWT deductions:

(a) Dividends derived by companies as exempt income;
(b) Deemed dividends where excessive salary or wages or remuneration is paid to shareholder, director or a relative, or a rebate from a mutual association;
(c) Attributed repatriations;
(d) Dividends derived when the recipient holds a certificate of exemption;
(e) Dividends constituting non-resident passive income;
(f) Dividends which are derived by a non-resident and do not have a New Zealand source;
(g) Dividends passing between companies which, at the time of payment, are members of the same group;
(h) Dividends which are expressly exempt income by any other Act, to the extent of the exemption;
(i) Dividends paid by qualifying companies [s HA 14(4)];
(j) Dividends paid and distributions of income by portfolio investment entities;
(k) Contributions to retirement savings schemes;
(l) Dividends (other than non-cash dividends) that have an imputation ratio or FDP ratio (or a combination of both) of 30/70 or greater paid by a unit trust or group investment fund where RWT has not been deducted from any previous dividend; and.
(m) A dividend which is deemed to arise under a dividend stripping arrangement [see 80.22].

TaxNote: When beneficiary income is also derived by a trustee who holds a certificate of exemption, that income is deemed not to be derived by the trustee, but by the beneficiary. This ensures that beneficiary income (ie resident passive income) derived through a trust retains its character. Therefore, if the beneficiary does not have a certificate of exemption, resident passive income derived by the beneficiary is subject to RWT — if the RWT is not deducted, the trustee may be liable to deduct [see 1260.80].

Where the criteria in s RE 4 are met, a company that is not resident in New Zealand is liable to make deductions of RWT if they carry on a taxable activity in New Zealand through a fixed establishment in New Zealand. However, in the case of dividends, a liability to deduct RWT does not apply if:

(a) The payment is attributable to or effectively connected with a fixed establishment of that person outside New Zealand, or the company is not resident in New Zealand; and
(b) All amounts payable are payable in a currency other then New Zealand currency.

A non-resident company with a branch (fixed establishment) in New Zealand is liable to deduct RWT from dividends paid unless the dividends were in a currency other than New Zealand dollars.

1260.65 The connection between RWT and imputation credits

The following table shows the relationship between RWT and imputation credits. RWT is imposed on all dividends paid by companies (except dividends paid by qualifying companies) but it should also take into account any imputation credits attached to the dividends.
### Resident Withholding Tax

<table>
<thead>
<tr>
<th></th>
<th>Fully imputed dividend</th>
<th>Partially imputed dividend</th>
<th>Nil imputed dividend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend</td>
<td>$700</td>
<td>$670</td>
<td>$670</td>
</tr>
<tr>
<td>Imputation credits</td>
<td>$300</td>
<td>$200</td>
<td>nil</td>
</tr>
<tr>
<td>Gross dividend</td>
<td>$1,000</td>
<td>$870</td>
<td>$670</td>
</tr>
<tr>
<td>Gross RWT (calculated as 33% of the gross dividend)</td>
<td>$330</td>
<td>$287</td>
<td>$221</td>
</tr>
<tr>
<td>Less imputation credits</td>
<td>$300</td>
<td>$200</td>
<td>nil</td>
</tr>
<tr>
<td>Net RWT</td>
<td>$30</td>
<td>$87</td>
<td>$221</td>
</tr>
<tr>
<td>Net dividend received</td>
<td>$670</td>
<td>$583</td>
<td>$449</td>
</tr>
</tbody>
</table>

The company tax rate was reduced from 33 per cent to 30 per cent from the 2008-2009 income year. There was no corresponding reduction in the RWT rate applicable to dividends. This has resulted in an obligation for companies to deduct RWT from fully-imputed dividends.

**TaxNote:** From the 2011-2012 income year, the company tax rate is 28 per cent. This means that dividends will, in most cases, be imputed at the rate of 28/72 rather than 30/70. As there has been no corresponding reduction in the RWT rate, RWT will still be required to be deducted from dividends even where they have been fully imputed at the new ratio. As was the case when the company tax rate was reduced from 33 per cent to 30 per cent a transitional measure will provide a short period during which the old ratio may continue to be used. Dividends paid by unit trusts and group investment funds are not subject to RWT [see 1260.60 (item “(l)” in the list)].

### 1260.70 Taxable Maori authority distributions [ss RE 16, RE 24]

Taxable Maori authority distributions are subject to resident withholding tax (RWT) [see 950 MAORI AUTHORITIES].

If a taxable Maori authority distribution is paid in the form of money or a credit of an amount of money to the balance of an account with the Maori authority, the amount of RWT is calculated as follows:

\[(a \times (b + c)) - c\]

Where:
- \(a\) is 19.5 per cent or (if the distribution is more than $200 and the Maori authority does not have a record of the tax file number of the recipient) 38 per cent [see sch 1, Part D, cl 6, Table 4];
- \(b\) is the amount of the distribution before the deduction of RWT;
- \(c\) is the amount of the Maori authority credit attached to the distribution.

If the taxable Maori authority distribution is not a payment in cash or a credit to the balance of an account with the Maori authority, the amount of RWT is calculated as follows:

\[((\text{tax rate} \times \text{distribution amount}) / (1 - \text{tax rate})) - \text{credit attached}\]

Where:
- “Tax rate” is the basic rate set out in sch 1, Part D, cl 6, Table 4;
- “Distribution amount” is the amount of the distribution before the amount of tax is determined;
- “Credit attached” is the amount of the Maori authority credit attached to the distribution.
Where the distribution is not a payment in cash or a credit to the balance of an account with the Maori authority, RWT is not actually deducted from the distribution. Instead, the Maori authority is liable to pay an amount that is equivalent to the amount calculated. This means that the recipient of the distribution receives the gross amount. The amount of RWT paid by the Maori authority is treated as a deduction of RWT. RWT deductions from taxable Maori authority distributions must be paid to Inland Revenue monthly by the 20th of the month following the month of deduction, as for dividends.

Where a Maori authority, in error, deducts too much RWT from a distribution, the excess may be paid to the recipient at any time on or before 31 March in the year the deduction was made, provided, at the time of payment, a notice of amounts distributed has not been given to the recipient under s 31 of the TAA or a notice including the excess deduction has been returned and cancelled.

1260.73 Replacement payments under a share-lending arrangement

Replacement payments under a share-lending arrangement are subject to deduction of RWT. The amount of RWT is calculated under the following formula:

\[
\text{((tax rate} \times \text{payment}) / 1 – \text{tax rate}) – \text{credit attached} – \text{credit transferred} – \text{FDP credit transferred}
\]

Where:
“Tax rate” is the basic rate set out in sch 1, Part D, cl 5;
“Payment” is the amount of the replacement payment excluding an imputation credit attached under section OB 64 (Replacement payments);
“Credit attached” is the amount of an imputation credit attached to the replacement payment under s OB 64;
“Credit transferred” is the amount of an imputation credit shown in a credit transfer notice relating to the replacement payment; and
“FDP credit transferred” is the amount of an FDP credit shown in a credit transfer notice relating to the replacement payment.

1260.75 RWT on foreign currency [s RE 17]

The payment of an RWT deduction, which is required on income in a currency other than New Zealand dollars, may be made in that foreign currency and if so:

(a) The person deriving the income has a credit for RWT against income tax assessed which may be converted into New Zealand dollars at either:
   (i) The close of trading spot exchange rate on the day of the deduction of RWT; or
   (ii) Such exchange rate specified for this purpose by the CIR for the month of the deduction of RWT; and

(b) The person making the deduction of RWT converts the deduction into New Zealand dollars at the close of trading spot exchange rate on the first working day of the month following the month of deduction.

If an Australian ICA company has deducted RWT from a dividend, the company can choose to convert the deduction at the rate specified in s OB 60(6). That rate is the close of trading spot exchange rate for the Australian dollar:

(a) For the date on which the dividend is declared (if less than three months before the dividend is paid); or

(b) For the date on which the dividend is paid (if more than three months before the dividend is paid).

1260.80 Resident passive income received by agents or trustees [s RE 7]

Where resident passive income is:

(a) Received by an agent or trustee for another person; and
(b) RWT in whole or part was not deducted; and
(c) The agent or trustee recipient either holds a valid certificate of exemption, or receives payment wholly or partly in the course of the agent or trustee’s taxable activity.

RWT is required to be deducted by the trustee or agent either in full or for the deficiency, as relevant. The RWT is required to be paid to Inland Revenue by the 20th of the month following the month payment is received. This does not apply where the agent or trustee has a valid certificate of exemption issued to that person and receives payment as a trustee of a trust (not being a bare trust).

Where a deduction is required of RWT from a dividend which is not “a dividend treated as interest” the RWT deduction is treated as if the dividend were a dividend treated as interest.

Where a deduction is required of RWT from non-cash dividends, the payer does not make a deduction of RWT but is liable to pay to the CIR an amount which is equal to the RWT that would have been required to be deducted. The amount is then treated as RWT.

These provisions do not restrict a deduction of RWT when making a payment, whether in the capacity of agent or trustee for another person.

1260.85 Dividends treated as interest [s YA 1]

“Dividends treated as interest” are dividends that are paid by a company which at that time is:
(a) Not resident in New Zealand; or
(b) Prohibited by its constitution from distributing income or property to any proprietor, member or shareholder; or
(c) A company which is exempt from income tax on its income (except for a company whose only income is foreign exempt dividends or dividends from companies in the same wholly-owned group as itself); or
(d) A company engaged in New Zealand solely in the business of life insurance or reinsurance which does not maintain a FDP account.

Generally, a dividend treated as interest is not subject to the imputation rules. Thus, these dividends are treated more akin to interest for RWT purposes, although the rates of RWT are those applicable to dividends. These dividends have no imputation credits to attach. Additional notification requirements apply to dividends treated as interest for RWT (much as for interest).

1260.90 Payment of RWT to Inland Revenue [ss RE 20, RE 21]

(1) Interest

Those persons required to deduct RWT on interest and who estimate for the relevant year that RWT will be $500 or more per month are required to make monthly remittances, no later than the 20th day of the following month. Others who deduct less than $500 pay by two instalments on:
(a) 20 October, for RWT deducted 1 April to 30 September; and
(b) 20 April, for RWT deducted 1 October to 31 March.

Where a payer who estimated RWT at less than $500 per month now pays $500 or more in aggregate since the last relevant payment month (either September or March) that person is required to pay all RWT on interest since the relevant month to Inland Revenue not later than the 20th day of the month in which aggregate deductions exceed $500.

(2) Dividends

All deductions are paid monthly by the 20th of the month following deduction. Payments to Inland Revenue are made on form IR15P. Where a person ceases to hold a valid certificate of exemption and ceases to carry on a taxable activity or ceases the taxable activity in New Zealand, all deductions of RWT are payable by the 20th day of the following month. A person may cease to have a valid certificate of exemption and is not
required to make deductions in a continuing activity. That person must pay all RWT not paid earlier no later than the 20th of the following month.

1260.100 RWT deductions varied to correct errors [ss RA 11, RA 12]
The failure to deduct RWT, or to deduct in full, from a recipient may be corrected by a further deduction from interest or dividends treated as interest in the same year or otherwise by recovery from the recipient.

If too much RWT has been deducted, the payer may pay the excess amount to the payee at any time before the end of the tax year in which the amount of tax is withheld. The following conditions apply:

(a) Where the payment was for interest or a dividend treated as interest, an RWT withholding certificate relating to that payment has either not been sent out or has been returned and cancelled;

(a) Where the payment was for a dividend other than a dividend treated as interest, a shareholder dividend statement relating to the amount has either not been sent out or has been returned and cancelled; and

(a) Where the payment was for a taxable Maori authority distribution, a notice relating to the amount has either not been given to a member of the Maori authority or has been returned and cancelled.

An act or omission on the part of a recipient which leads to over-deduction and payment to Inland Revenue does not lead to a refund of the excess to the recipient or any other person. Payers may make refunds at any time up to 31 March of the year in which the mistake was made provided that no RWT certificate or shareholder dividend statement is issued, or if it has been issued, that it has been returned and cancelled.

1260.105 Refunds of deductions [ss RA 12, RA 19, RE 10B, RM 8]
When the amount of RWT deducted and paid to Inland Revenue exceeds the amount required by the RWT rules, Inland Revenue will refund the excess. The refund is paid to the person deriving the income from which the deduction was made. If the person who made the excess deduction has already (under s RA 12), paid the excess to the person deriving the income, the refund is paid to the person who made the excess deduction.

If the person to whom a refund is payable has any amount owing to the CIR under the ITA or TAA, the CIR may offset the refund against the amount due. The date of the offset will be the date requested by the taxpayer under s 173T of the TAA or, if no such request is made, a date determined by the CIR.

Where a person:

(a) Receives a distribution in relation to an attributing interest in a foreign investment fund; and

(b) The comparative value method, deemed rate of return method, fair dividend rate method or cost method applies to the distribution [see 850 INTERNATIONAL TAX REGIME]; and

(c) RWT has been withheld from the distribution:

the distribution is treated as being resident passive income, and the amount withheld is treated as RWT and becomes a tax credit. This treatment does not apply where either the payer or the or the recipient has applied for a refund of the amount withheld prior to 31 March following the date of the distribution.

1260.110 RWT deduction certificates [TAA, s 25]
These apply to RWT on interest or dividends treated as interest. Certificates must be given by 20 May for the prior year ended 31 March. They may be given on annual figures, or each payment made of resident passive income.

A recipient may request at any time an RWT deduction certificate for a financial arrangement that has matured, been remitted or disposed of by the recipient. The payer must then prepare and provide the certificate to the recipient within 20 working days of the request.

A person who ceases to have a valid certificate of exemption and who ceases to carry on any taxable activity for which RWT deductions have been required or ceases to carry on such taxable activity in New Zealand, must prepare and provide RWT deduction certificates to recipients not later than 20th of the following month.

A person who ceases to have a valid certificate of exemption and is no longer required to make deductions due to not continuing in a taxable activity must follow the same procedure.
A RWT deduction certificate must include the following:

(a) A statement as to whether the resident passive income is interest or dividends treated as interest other than non-cash dividends;

(b) The date on which the deduction was made, or if there is more than one deduction, the year in which the deductions were made;

(c) The amounts of resident passive income and RWT deductions; and

(d) From the 2010-2011 income year, the rate for the resident passive income. That rate is:
   - Found by dividing the total amount of RWT withheld by the amount of resident passive income;
   - The rate at which RWT would have been withheld if the resident passive income had been paid or derived at the end of the relevant tax year;
   - The rate at which RWT was withheld during the relevant tax year, together with, if more than one RWT rate applied for the resident passive income, the amount to which each rate applied and the amount withheld at each rate.

The new requirement accommodates complications caused by a change in RWT withholding rate part way through a period.

“RWT rate” is the basic rate for RWT under sch 1, part D.

A certificate of RWT for an annual total not exceeding $50 is not required to be prepared unless written notice is given by the recipient and then the certificate must be prepared and provided within 20 working days. An RWT certificate must be retained for three years after the end of the relevant year, unless otherwise permitted by the CIR. Joint accounts may be treated as one certificate either in the name of one or more persons nominated by the persons or in the name of those persons jointly. A certificate given personally, posted to the last address, given to an authorised person or posted to their last address, or sent electronically to the person or a person authorised to act on their behalf, is deemed to have been provided to the recipient.

1260.115 RWT reconciliation statements [TAA, s 51]

Persons who deduct RWT from either interest, dividends treated as interest, or dividends must furnish a statement to the CIR by 31 May following the end of the year of deduction. The statement must be in the form prescribed, and contain the information specified, by the CIR.

The CIR may require the following information in relation to a deduction of RWT:

(a) The full name, address and tax file number of the payer;

(b) The full name and last known address of the recipient unless, after making reasonable inquiries, the payer is unable to obtain those details;

(c) The tax file number of the recipient, if known to the payer;

(d) Whether the resident passive income is interest or dividends treated as interest or dividends (other than non-cash dividends);

(e) The date on which the deduction was made or, if there is more than one deduction, the year in which the deductions were made;

(f) The amounts of resident passive income and RWT deductions; and

(g) Further information that the CIR considers relevant.

If a person has paid interest, dividends treated as interest, or dividends to another person without deducting RWT because the recipient holds a valid certificate of exemption, the CIR may require the following information:

(a) The full name and last known address of the recipient;

(b) The total interest or dividends treated as interest, or dividends paid to the recipient;

(c) The recipient’s tax file number, unless the recipient is, at the time of payment, a registered bank, a building society, a trustee bank, or the Public Trust (or a company that would be a member of the same wholly-owned group of companies as the Public Trust, if it were a company); and
(d) Further information that the CIR considers relevant.

Such information required by the CIR must be provided within 20 working days of the request. On the cessation of a taxable activity where a person ceases to hold a valid certificate of exemption, or ceases business in New Zealand, the information must be furnished within 40 working days after the end of the month in which taxable activity ceased. Similarly, if a valid certificate of exemption ceases and the payer is no longer required to make RWT deductions in carrying on a taxable activity, the information is required within 40 working days after the end of the month in which the certificate of exemption ceased. The CIR has power to vary these requirements.

1260.120 Disclosure of interest paid where no RWT deduction required

[TAA, s 52]

Details are required in a person’s annual tax return where a payment is made of interest which is resident passive income, but no RWT deduction is required because either:

(a) The payment was not made by the payer in the course of furtherance of a taxable activity; or
(b) No deduction is made because total resident passive income interest paid is less than $5,000; and
the payment is claimed as a deduction when calculating net income and payment is made to someone who has no valid certificate of exemption. The information required includes:

(a) Name and address and tax file number of the recipients; and
(b) Interest resident passive income total paid to each recipient.

A recipient who receives interest resident passive income from which no RWT is deducted because payment was not made in the course or furtherance of a taxable activity or because interest RWT is less than $5,000 is required to provide the payer with his or her tax file number within 10 working days of the request from the payer.

1260.125 RWT deductions credited against income tax assessed [ss LA 4, LA 6, LB 3]

Where a person derives resident passive income from which RWT deductions have been made, the amount of resident passive income is grossed up to include the RWT deductions. The RWT deductions (excluding any penalties) are credited successively against:

(a) Income tax payable for the current tax year;
(b) Income tax payable for previous tax years;
(c) Income tax payable for a subsequent tax year; and
(d) Provisional tax payable for a subsequent tax year (in the order of the years, if more than one).

A credit of tax is not allowed and a refund must not be paid unless the CIR has received an RWT deduction certificate or other satisfactory evidence in writing showing the deduction. The CIR may amend an assessment or determination at any time to give effect to s LA 6, notwithstanding the time bar.

1260.135 Certificates of exemption [s RE 27; TAA, ss 32E(2), 32F, 32G, 32H]

A person falling within any of the exempt categories listed below may apply to the CIR for a certificate of exemption. The application should be made on form IR451, and must state which category the person is applying under and contain a declaration that the applicant comes within that basis of exemption. The CIR may require the applicant to provide further information, including books of account, to support the application.

If the CIR is satisfied that an applicant meets the criteria for an exemption, the CIR will issue a certificate of exemption to the applicant. The certificate must:

(a) State the date of issue and the date of termination (if any) of the certificate; and
(b) Bear the applicant’s tax file number.
The certificate is valid from the date of issue. If it is lost or destroyed, the CIR may issue a replacement.

The categories of person that qualify for a certificate of exemption are as follows:

(a) Any registered bank defined in s 2 of the Reserve Bank of New Zealand Act 1989;
(b) Any building society;
(c) The Public Trust, or any company which would be a member of the same wholly owned group of companies as the Public Trust, if the Public Trust were a company, Maori Trustee, or a trustee company as defined in s 2 of the Trustee Companies Act 1967;
(d) A portfolio investment entity;
(e) Any person whose principal business is:
   (i) Borrowing money, accepting deposits, receiving credit, selling credit instruments; and
   (ii) Lending money, granting credit or buying or discounting credit instruments;
(f) A solicitor’s nominee company subject to the rules under s 96 of the Lawyers and Conveyancers Act 2006 and operated by a barrister and solicitor or an incorporated law firm; or
(g) A broker’s nominee company subject to the Securities Act (Contributory Mortgage) Regulations 1988;
(h) Any practitioner within the meaning of the Lawyers and Conveyancers Act 2006 for the operation of a trust account maintained in accordance with s 89 of the Law Practitioners Act 1982;
(i) A person who has filed all required returns of income in the time required and has in the most recent return over $2 million of annual gross income before allowable deductions. Companies which are members of a wholly owned group may combine their income for obtaining a certificate of exemption, provided the income from transactions or related or connected transactions with another member of the group are excluded. However, each company in a group must apply for a certificate of exemption separately. There is no provision for group registration;
(j) A person who has reasonable grounds for believing that total gross income before allowable deductions will exceed $2 million in the next accounting year. Companies with anticipated membership of a group may combine, but income from inter-group transactions must be excluded from the $2 million estimate. However, each company in a group must apply for a certificate of exemption separately. There is no provision for group registration;
(k) Any taxpayer with exempt income of the following kinds: public authorities generally, local authorities generally, local and regional promotional bodies, charities, charitable estates, friendly societies, funeral trusts (interest and dividend income), amateur sports promoters, the TAB and racing clubs, gaming machine operators, scientific or industrial research societies, veterinary service bodies, herd improvement bodies, Cornwall Park trustees, and community trusts. The exemption only applies to the exempt activities, not to any other activities;
(l) Any non-profit body within the meaning of s DV 8 [see 225.60], whose income for the most recently completed accounting year would, but for the deduction permitted by s DV 8, be $1,000 or less;
(m) A board of trustees that is constituted under Part 9 of the Education Act 1989 and that is not carried on for the private pecuniary profit of any individual;
(n) A tertiary education institute that is established under Part 14 of the Education Act 1989 and that is not carried on for the private pecuniary profit of any individual;
(o) The trustee of the Niue International Trust Fund or of the Tokelau International Trust Fund.

1260.140 Payer’s obligations under a certificate of exemption [s RE 29; TAA, ss 32G, 32H, 32I]

Where any person makes a payment to a second person or receives a payment as agent or bare trustee for that second person, then for the purposes of determining the first person’s liability to make a deduction of RWT that payment is deemed not to constitute resident passive income if:
(a) The payer has taken reasonable steps to confirm that the recipient is a bank, trustee bank, building society, trustee company, Maori Trustee, or Public Trustee. It is not necessary to sight the certificate of exemption as long as the identity of the payee is known; or

(b) The certificate of exemption is sighted and the exemption or tax file number obtained.

Otherwise, the first person should sight the certificate of exemption issued to the second person and take reasonable steps to see that the second person is the person named in the certificate. If not, there would be an obligation to deduct RWT.

Furthermore, the payer should be satisfied that no Gazette notice has cancelled a certificate of exemption:

(a) For interest more than five working days before the money was lent;

(b) For dividends or taxable Maori authority distributions more than five working days before payment is made.

If a notice is published the payer must sight a certificate of exemption issued to the recipient and dated after the Gazette’s issue date for the cancellation notice.

The payer also needs to be satisfied that no notice of cancellation of a certificate of exemption held by the recipient has been gazetted more than five working days before payment. If it has been gazetted, the payer needs to be satisfied that a certificate of exemption is sighted that is dated after the date of the Gazette notice of cancellation or the Gazette has published subsequently, and before more than five working days before payment is made, notice of reissue of the certificate of exemption.

The CIR, or the recipient, may also advise payers of the cancellation of the certificate of exemption more than five working days before the day on which payment is made. The notice is revoked by a Gazette notice, given subsequent the advice, of the issue of a further certificate of exemption to the recipient more than five working days before payment is made. Alternatively, a certificate of exemption is sighted with a date of issue subsequent to the advice being received. In addition, the payer must not have any grounds for believing the recipient is not eligible for a certificate of exemption and in the case of the recipient being a bank, building society, or trustee bank, the payer has no grounds for believing that interest or dividends are income derived by any person other than such organisations. The CIR may require an applicant for a certificate of exemption to provide information, including books of account, accounting information, or records relating to the applicant.

A person whose estimated income exceeds $2 million must provide to the CIR within three months of the end of the accounting year evidence of the actual gross income before allowable deductions. In the event that the total is less than $2 million, late payment penalties will be payable as if default had occurred on each day the recipient received or derived payment from which RWT would otherwise have been deducted [see 1110.40]. The CIR has a discretion to issue a certificate of exemption or permit its retention or remit any late payment penalty where the $2 million was not attained and failure is solely a consequence of extraordinary circumstances beyond the reasonable control of the applicant and not likely to be repeated. The CIR also has discretion to issue a certificate of exemption valid until date of termination specified (if any) where satisfied either that a person:

(a) Will or is likely to incur a loss, or aggregate entitlement to deductions are likely to be not less than aggregate income; or

(b) Would be likely to be entitled to claim aggregate RWT credits exceeding their income tax liability for an income year by $500 or more.

1260.145 **Unincorporated bodies** [s RE 30; TAA, s 32J]

If the body carries on a taxable activity, it may be issued with a certificate of exemption. The certificate of exemption must be in the name of the body. Where the body is a trustee of a trust, the certificate must be in the name of a trust. Members of the body are not, themselves, issued with a certificate of exemption for the taxable activity and payments made in the course of carrying on that taxable activity are deemed to be made by the body and not by the members. Similarly, payments to members acting as a member in the course of carrying on that taxable activity are deemed payments to the body and not to the member. Members become
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jointly and severally liable for RWT payable while members. Members of a partnership joint venture, or the
trustees of a trust do not cease to be members until written notice of the change is given to the CIR.
A notice addressed to the body in the name for the certificate of exemption is deemed to be served on all
members and makes all members jointly and severally liable for anything required to be done for RWT. For
a body which is not a partnership, joint venture, or trustees in a trust, where the affairs are managed by
members or a committee of members, anything required to be done for RWT becomes the joint and several
responsibility of:

(a) The president, chairperson, treasurer, secretary, or similar officeholder; or
(b) In default of any such member, then every member of a committee.

1260.150 Cancellation of certificates of exemption [s RE 27; TAA, ss 32K, 32L]

Where a certificate of exemption ceases to be valid on the basis of the exemption that was specified on the
application for the certificate of exemption, the person who holds the certificate of exemption must, within
five working days of becoming aware of that fact:

(a) Inform the CIR of the fact;
(b) Deliver the certificate of exemption to the CIR; and
(c) If requested, provide the CIR within five working days the full names and addresses of all persons
to whom the certificate of exemption has been shown for purposes of exemption from RWT.

The CIR may cancel a certificate of exemption at any time in the following circumstances:

(a) If the CIR believes the basis of exemption specified in the application no longer applies;
(b) If a person is not within the basis of exemption specified and obtained the certificate of exemption
through misleading information or otherwise should not have been issued with a certificate of
exemption;
(c) If the certificate of exemption basis was an estimate that income would exceed $2 million, if:
   (i) The evidence required within three months after the 12-month period shows that the target
   was not met; or
   (ii) Satisfactory evidence is not furnished as required; or
   (iii) The CIR has reason to believe the evidence provided is materially incorrect or is misleading;
   and
(d) If any income tax is not paid by due date.

The CIR must then notify the person of the certificate of exemption cancellation and the person must, within
five working days of notification return the certificate of exemption and if requested provide full names and
addresses of all persons to whom the certificate of exemption has been shown for purposes of exemption
from RWT.

Except when income tax is not paid by the due date, where the CIR is satisfied that a further basis of exemption
exists, the CIR must not cancel a certificate of exemption (unless issuing a substitute certificate with
immediate effect).

Any person notified that the certificate of exemption has been cancelled must within five working days inform
in writing all persons to whom the certificate of exemption was shown for exemption purposes and from
whom further payments of resident passive income are expected, of the certificate of exemption cancellation.
Cancellations are published in the Gazette:

(a) By 30 June each year giving:
   (i) A list of certificate of exemptions cancelled in the preceding year which were not
   subsequently reissued; and
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(ii) A list of certificate of exemptions issued in the preceding year to persons who in years prior to the preceding year previously held a certificate of exemption.

(b) In April, July, October, and January giving:
(i) A list of certificate of exemptions cancelled for the three months ending prior to the month of publication, where certificate of exemptions were not reissued in that three-month period; and
(ii) A list of certificate of exemptions reissued, from previous three-monthly periods, in the current three-month period.

Lists of cancelled certificates of exemption may also be published by electronic means.

A person required to deliver up to the CIR a certificate of exemption deliver up all original copies issued. A gazetted notice of a certificate of exemption cancellation causes the certificate of exemption to be invalid five working days after the date of publication, and where persons are informed by the CIR or the previous holder of a certificate of exemption that the certificate of exemption has been cancelled, the certificate becomes invalid five working days after the person has been informed.

1260.155 Records [TAA, s 26]

A person required to make RWT deductions must keep, in English, sufficient records to enable the following to be ascertained for each amount of resident passive income:

(a) The resident passive income before making the RWT deduction;
(b) The amount of RWT deduction;
(c) The date the RWT was required to be deducted;
(d) The full name and last address of the recipient or person deriving the resident passive income;
(e) For interest, any number used to identify the financial arrangement on which interest was paid (ie bank account number, etc); and
(f) Such other information as the CIR may require.

Where payments of interest and dividends are made to a person with a certificate of exemption, records in English must show for each amount:

(a) Amount and date RWT deduction would have been required;
(b) Full name and last address of the recipient; and
(c) The recipient’s tax file number.

A record at the end of each year is required, per recipient, for interest or specified dividends paid comprising:

(a) The total amount of interest and dividends treated as interest paid; and
(b) Details of all other financial arrangements under which interest was paid to that recipient at any time during that year.

Every person required to provide information to the CIR must keep the records in English to substantiate the details disclosed to the CIR. Reasonable precautions for the safe custody of all records must be maintained for seven years after the year end to which they relate. Provision is made for notice in writing by the CIR that retention is not required or the law requires delivery of records to another person or the person is a company which has been wound up and dissolved. Similar provisions to income tax records apply to extend the seven-year period to 10 years in certain cases. The CIR has a discretion, responding to a written application, to authorise by written notice records required in another language.

1260.160 Recovery of RWT deductions [TAA, s 170]

RWT is held in trust for the Crown and is not part of the property of any person liable to execution and forms no part of an estate in bankruptcy, liquidation, or assignment for creditors. In a company liquidation RWT deductions are payable after debts but in priority to holders of debentures under any floating charge.
1260.165 **Unpaid RWT deductions constitute a charge on payer’s property** [TAA, s 172]

Failure to deduct or pay the full RWT, together with late payment penalty or shortfall penalty, gives rise to a charge on all real and personal property for the amount unpaid plus any judgment fees, costs, or expenses.

1260.170 **Failure to make RWT deductions** [TAA, s 171]

Failure to make RWT deductions gives rise to a debt due to the CIR of the amount that should be deducted on the day it should be duly paid. The CIR may recover any RWT deduction from the payer in addition to the right to recover from the recipient and may recover from both concurrently, or wholly from one, or partly from one and partly from the other. However, where any liable person can satisfy the CIR that another person has made the deduction of RWT from the relevant resident passive income, that deduction is deemed to have been made.

1260.175 **Assessment of RWT deductions** [TAA, s 99]

Assessments for a failure to deduct, or a failure to pay deductions to the CIR by a payer, may be made. The same rights to challenge apply.

1260.180 **Disclosure of transactions in financial arrangements** [TAA, s 53]

A person who holds a certificate of exemption at any time during that year must disclose certain details in his or her return of income where a financial arrangement was acquired, disposed of, or redeemed and the other party to the transaction was not the issuer of the financial arrangement or at the time a holder of a valid certificate of exemption. The financial arrangement must be one for which interest is payable or where no RWT deduction in the case of a redemption payment has been made. The information to be disclosed includes:

(a) The full name and last address of the non-exempt person;
(b) The date of acquisition, disposition, or redemption;
(c) The consideration paid or received by the exempt person for acquisition, disposition, or redemption, exclusive of any fees;
(d) The tax file number (if any) of the non-exempt person;
(e) Further information that the CIR may prescribe.

Summary totals for all acquisitions, dispositions, and redemptions are separately required, except where the CIR otherwise requires, for items (b) to (e) for each non-exempt person in that year.

Every non-exempt person who enters into an acquisition, disposition, or redemption payment of a financial arrangement and who has a tax file number must, on request from the exempt person, provide it within 10 working days.
Chapter 1265

Restrictive Covenants and Exit Inducements

1265.10 Restrictive covenants
A restrictive covenant payment is the consideration given for a restriction on a person’s right to perform services. Under a restrictive covenant (also known as a restraint of trade agreement), an employee agrees not to compete with a former employer after leaving the employment. In return for that agreement, the employee is granted a payment. A restraint of trade agreement can take many forms, such as an agreement:

(a) Not to compete with a former employer within a certain time-frame;
(b) Not to compete with a former employer within a certain geographical area;
(c) Not to use secret knowledge concerning industrial or scientific processes obtained whilst working for the former employer; or
(d) Not to approach a former employer’s customers.

The Courts generally take the position that restraints of trade are contrary to public policy and therefore void. They are considered valid only where the restraint is justified by the special circumstances of the particular case, and the restraint is reasonable.

If a person gives an undertaking that restricts, or is intended to restrict, the person’s ability to perform services as an employee, office holder or independent contractor, any amount derived in respect of that undertaking is assessable income of that person. This applies whether or not the undertaking is legally enforceable and whether or not the payment is derived by the person giving the undertaking [see TIB vol 13:5 (May 2001) at 18-23, TES 9 (October 2003) 124].

The payment is not taxable if all of the following apply:

(a) It is derived by the person giving the undertaking (person A) as a result of person A (or an associate of person A) selling a business to another person (person B);
(b) The payment is consideration for an undertaking by person A not to provide goods or services in competition with the goods or services to be provided by person B;
(c) Person A does not provide services, other than temporary services incidental to the sale, to person B after the business is sold; and
(d) Persons A (or an associate of person A) agrees in writing with person B that the transaction is a sale of a business.

For the purposes of this exemption, the sale of a business includes:

(a) The sale of part of a business, if the part is capable of separate operation; or
(b) The sale of all of the shares in a company, if the company (or a wholly owned subsidiary of the company) is carrying on a business.

Restrictive covenant payments are taxable at source at the extra pay rate and also subject to ACC earner levies.
1265.20 Exit inducement payments [s CE 10]

An exit inducement payment is the consideration given by a prospective employer or contractor to a person to give up a particular status or position. The amount derived by a person for a loss of vocation or a position, for leaving a position, or for a loss of status is assessable income of the person [see TIB vol 13:5 (May 2001) at 18-23].

Exit inducement payments are taxable at source at the extra pay rate and are subject to ACC earner levies.

1265.30 Expenditure incurred on restrictive covenants and exit inducements [s DC 9]

Expenditure incurred by a taxpayer is deductible if the amount is assessable to another person as a restrictive covenants or exit inducement payment. The capital limitation contained in s DA 2(1) is specifically overridden.

If services are performed for the taxpayer by the employee, office holder or independent contractor who gave the undertaking under the restrictive covenant or who received the exit inducement, the expenditure is not deductible to the extent to which it would have been of a capital nature if the restrictive covenant payment or an exit inducement payment had not been made.

1265.40 Repayment of a restrictive covenant or exit inducement [s DB 48]

If a person who has received a taxable restrictive covenant payment is required to repay some or all of the payment because they have breached the covenant, the amount repaid is an allowable deduction. The deduction is allowed despite the s DA 2(4) employment limitation. The amount of the deduction is the lesser of the amount repaid and the amount of assessable income derived on receipt of the restrictive covenant payment.

No deduction is permitted for interest, punitive or exemplary damages, or the employer’s legal or other expenses. The deduction is allowed in the income year in which the amount is repaid [see TIB vol 13:5 (May 2001) at 18-23].

1265.50 Avoidance arrangements [s GB 30]

If a person enters into an arrangement that has the effect of avoiding the restrictive covenant provisions of s CE 9, the CIR may treat:

(a) The amount (or part of the amount) under the avoidance arrangement as assessable income of the recipient under s CE 9; and

(b) A person affected by the arrangement as the person who gave the undertaking.

A collateral arrangement to dispose of property may be part of an avoidance arrangement [see TIB vol 13:5 (May 2001) at 18-23].
Chapter 1270

Returns of Income

1270.05  Primary obligations of taxpayers [TAA, ss 15A, 15B]

The primary obligations of a taxpayer under the tax laws are to:

(a) Make an assessment if required to do so under a tax law;
(b) Correctly determine the amount of tax payable under the tax laws (unless the taxpayer is a non-filing taxpayer);
(c) Deduct or withhold the correct amounts of tax from payments or receipts when required to do so by the tax laws;
(d) Pay tax on time;
(e) Keep all necessary information (including books and records) and maintain all necessary accounts or balances required under the tax laws;
(f) Disclose to the CIR in a timely and useful way all information (including books and records) that the tax laws require the taxpayer to disclose;
(g) Co-operate with the CIR in a way that assists the exercise of the CIR’s powers under the tax laws, to the extent required by the Inland Revenue Acts;
(h) Comply with all the other obligations imposed on the taxpayer by the tax laws;
(i) Inform the CIR that an income statement/personal tax summary [see 1270.75 Income Statement/Personal Tax Summary] has not been received. This is required where the taxpayer is an individual who should have received an income statement but has not by the prescribed date; and
(j) Correctly respond to any income statement/personal tax summary issued to them, if the taxpayer is an individual.

Obligation (a) applies from the 2002-2003 income year. Obligations (b) to (h) apply from the 1997-1998 income year. Obligations (i) and (j) apply from 1 April 1999.

1270.10  Income tax returns required [TAA, ss 33, 34, 35]

A taxpayer is required under s 33 of the TAA to furnish to the CIR a return of income. The return for an income year must be furnished during the following income year [see 1270.60] and must:

(a) Be in the prescribed form;
(b) Contain any other particulars that may be prescribed;
(c) Contain a notice of the assessment required to be made under s 92 of the TAA [see 80.10].

A “taxpayer” is a person who is, or may be, liable to perform or comply with an obligation imposed under the ITA 2007 or TAA 1994 [s YA 1]. This includes an agent acting on behalf of another person.

A taxpayer to whom s 33A of the TAA applies [see 1270.70], is not required to furnish a return.

A return which purports to be made by a person or on the person’s behalf is, for all purposes, deemed to have been made by that person or by that person’s authority, unless it can be proven otherwise: [TAA, s 34]. It is therefore assumed that a return completed and furnished to Inland Revenue by an agent was done so with the taxpayer’s authority.

Under s 35 of the TAA, the CIR has the power to prescribe any forms or electronic formats, for the purposes of any of the Acts administered by Inland Revenue, if they are not specifically prescribed in legislation.

Taxpayers exempted from filing returns who wish to claim the donations or child care rebates do so by completing a rebate claim form [see 1395.95]. Overpayments of tax will be automatically refunded in most cases.

The return requirements extend to every person carrying on a business regardless of whether an overall loss was claimed. A return of all the income means a return which showed whether the business had income for the year and how that result was achieved: Commissioner of Inland Revenue v Grover (1988) 10 NZTC 5,012, (1987) 11 TRNZ 315 (CA).

Taxpayers have a personal liability to file returns. Fines totalling $4,600 were imposed on taxpayers who were husband and wife who had, through their professional adviser, failed to file income tax returns for five years, although the PAYE and GST returns had been completed: Terry v Commissioner of Inland Revenue (1993) 15 NZTC 10,309 (1993) 18 TRNZ 334 (HC). Where a return in required to be filed by a company, the obligation rests with the company and not with the directors: Commissioner of Inland Revenue v Cary DC Auckland CIV-2008-004-518, 26 August 2008.

1270.20 Classes of return

The following is a list of return forms and the classes of taxpayers who are required to use them:

Form IR3 Return for all individuals who are not exempted from filing a return under s 33A(1) of the TAA.

Form IR4 Company return to be completed by all companies and public authorities.

Form IR6 Estate or trust return [TAA, s 43].

Form IR7 Partnerships [TAA, s 42]. Look-through companies [TAA s 42B]

Form IR8 Maori authorities [TAA, s 57].

Form IR9 Clubs and societies.

Form IR44 Registered superannuation funds.

1270.21 Privately printed return forms

Inland Revenue accepts privately printed return forms provided that the reproductions:

(a) Do not show the firm’s name other than as an address for the service of notices;
(b) Are exact copies of the official forms for the particular income year;
(c) Closely match the official form in colour;
(d) Are on equal, or better quality paper than the official form;
(e) Bear the taxpayer’s original signature;
(f) Are folded in the same manner as the official forms.

Negotiations should be made with the local Inland Revenue office [see PIB 68 (July 1972)].
1270.25 General requirements for returns [TAA, s 40]

The following general requirements must be met in relation to all returns:

(a) Returns required to be furnished in writing must be signed, and must contain all the necessary information and be accompanied by all the documents required under any of the Inland Revenue Acts; and

(b) Returns furnished electronically must be transmitted in an electronic format prescribed by the Inland Revenue, and must contain all the necessary information and be accompanied by all the documents required under any of the Inland Revenue Acts.

A return is treated as being furnished on the date it is received at an Inland Revenue office.

1270.30 Electronic filing of returns [TAA, ss 36, 40]

The CIR may give approval for tax returns to be filed by electronic means which comply with specific conditions. The taxpayer or registered person shall retain a hard-copy transcript of the information transmitted which shall be deemed the return. It shall be signed by the taxpayer or registered person and held on behalf of the CIR.

1270.40 Signing of returns [TAA, s 40]

Tax returns should be signed by the taxpayer. Where the taxpayer is not able to sign the return, Inland Revenue has no objection to an agent signing the return on the taxpayer’s behalf, provided of course that the agent has the necessary authority. Inland Revenue will not accept returns signed by agents where a disclaimer has been added to the declaration on the return form. If the agent feels not able to sign the return form without a disclaimer being added, then the taxpayer should sign it.

Inland Revenue accepts a disclaimer to the balance sheet of unaudited accounts as evidence that the accounts have not been audited. However, the declaration on the income tax return form should not be altered, amended or added to in any way by agents when they sign the return on behalf of a taxpayer [see PIB 121 (August 1983)].

Persons who sign returns on behalf of taxpayers under the powers of attorney assume personal liability if the return is incorrect.

1270.50 Proper completion of returns

If attention is given to the undermentioned items when preparing business taxation returns, they provide the necessary information, and needless correspondence with Inland Revenue may be avoided [see PIB 51 (September 1969) and PIB 121 (August 1983)]:

(a) Assets taken over: On incorporation of an existing business the assets are to be brought in at the values adopted by the vendor, unless other arrangements have been made with Inland Revenue.

(b) Bad debts: Confirm that the amount has been actually written off in the debtors accounts as a provision for doubtful debts is not allowable as a deduction.

(c) Business and rental losses: Briefly note the reason for continued losses and comment on future viability.

(d) Capital accounts: Record the source of any increase in capital.

(e) Depreciation: If an asset is sold during the year supply the information requested.

(f) Depreciation schedules: To be included.

(g) Development expenditure: Show separately items of farm developmental expenditure.

(h) General expenses: If claim is significantly larger than that usually claimed, note details of each item.

(i) Goods taken privately: Note the amount of adjustment and the basis on which the adjustment is based.

(j) Group companies: Generate a list showing the names of other companies which come within the same “group”.

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Husband and wife partnership: When the first partnership return is furnished Inland Revenue needs to know the source of opening capital, and duties in the business of both husband and wife.

Interest and rent paid: Complete the panel on the return form. The amount to be entered is that paid for the year ended 31 March and not to an otherwise non-standard balance date.

Land and buildings disposed of: Show the date of purchase, date of sale, purpose for which acquired and reason for sale.

Legal expenses: Record the nature of each item.

Livestock account: Reconcile any discrepancies in numbers.

Motor vehicle and plant lease: Supply copy of lease in first year in which these payments are claimed.

Private use of assets: Record what adjustments have been made for the private use of an asset.

Provisional income: If income is estimated for provisional tax show calculations clearly on the return form.

Repairs and maintenance: If claim is larger than usual brief details of the larger items will often avoid the need for further inquiry.

Stock: Note the basis of valuation of trading stock.

Travel expenses: Record separately internal and overseas travel expenditure. Give details of adjustments to be made for any private element, etc.

Unusual items: A brief explanation of any unusual or extraordinary items is helpful. Where financial statements are submitted, the items which are not deductible for tax purposes should be added back in the return form. Do not overlook:

- Payments to non-residents;
- Commissions, interest and royalties;
- Remuneration paid to shareholders and directors;
- Advances to shareholders and associated companies.

When to furnish returns [TAA, s 37]

The dates by which returns of income are to be furnished follow.

1. Taxpayers with an early or standard balance date

Taxpayers with an early [see 770.22], or a standard (31 March) balance date are required to furnish their returns by the following 7 July. For example, a taxpayer with a 31 December (early) balance date is required to file their return by the following 7 July.

2. Taxpayers with a late balance date

Taxpayers with a late balance date [see 770.23] are required to furnish their returns by the seventh day of the fourth month after balance date. For example, a taxpayer with a 30 June balance date is required to file their return by the following 7 October.

A return is deemed not to have been duly furnished until it has been received at any office of Inland Revenue. An electronic return is treated as having been duly furnished when the information contained in the return has been transmitted in the prescribed electronic format [TAA, ss 36, 40]

TRA Case T23 (1997) 18 NZTC 8,148 dealt with the issue of when a return is deemed to be furnished under s 40 of the TAA. The TRA held that a return sent by post was received by Inland Revenue when it was delivered into Inland Revenue’s private box or bag at a post office, not at the time it was subsequently delivered by NZ Post to an Inland Revenue processing centre or branch office.

Extension of time to furnish returns [TAA, s 37]

Any taxpayer may apply for an extension of time to file an income tax return. Before Inland Revenue will allow an extension of time it must be satisfied that the taxpayer is unable to file the return by the normal due
date. The application does not have to be in writing. Application should be made before the normal due date for the return, although Inland Revenue may extend the time for making application. Inland Revenue is unable to extend the time by which returns must be filed beyond the following dates:

<table>
<thead>
<tr>
<th>Taxpayer’s balance date</th>
<th>Final date by which returns must be filed</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 March</td>
<td>The following 31 March</td>
</tr>
<tr>
<td>1 October to 30 March</td>
<td>31 March following the next succeeding 31 March</td>
</tr>
<tr>
<td>1 April to 30 September</td>
<td>Next succeeding 31 March</td>
</tr>
</tbody>
</table>

(1) **Tax agents**

A tax agent who prepares 10 or more income tax returns for clients may be permitted an extension of time for filing these returns if the agent is unable to file them by due date, or if it would be unreasonable in the circumstances to require the agent to file them by due date. This concession applies only to:

(a) Persons carrying on a professional public practice;
(b) Persons carrying on the business of filing income tax returns;
(c) The Maori Trustee.

The extension of time (EOT) arrangements for agents are made by Inland Revenue each year in consultation with the Institute of Chartered Accountants of New Zealand. The concession is not automatic and agents are required to meet certain targets for filing returns by certain dates in order to retain their extension of time concessions.

The E-file agents target dates apply only to tax agents who file 80 per cent or more of their clients’ returns electronically. The E-file agents target dates cease to apply if the agent has filed paper returns for more than 25 per cent of their clients as at any target date.

The late balance date returns target dates apply to tax agents only if more than 25 per cent of the agent’s clients, who are required to file returns, have late balance dates.

If a tax agent fails to meet the above return filing percentage targets, the CIR may:

(a) Refuse to grant any further extensions of time for returns linked to that tax agent; and
(b) Cancel any existing extension of time arrangement granted to that tax agent for the income years for which the agent has not met the percentage targets. A cancellation may relate to some or all of the returns linked to the tax agent.

Inland Revenue will not take any action against a tax agent who achieves a filing percentage within five per cent of the target at each target date other than 31 March. For example, an E-file tax agent who files 74 per cent of their returns by the third target date (target 78.5 per cent) will not lose their automatic extension of time provided that 100 per cent of returns are filed by 31 March. This arrangement gives some flexibility to allow for individual agents’ circumstances and reduces the need for tax agents to negotiate individual arrangements.

Full details of the tax agents’ extension of time arrangement (EOT), including the percentage requirements for the income year, may be found in Inland Revenue Booklet IR9XA Extension of time (EOT) arrangements, which is available on the Inland Revenue website.

(2) **Taxpayers without tax agents**

The CIR’s policy on how Inland Revenue will deal with extension of time applications from taxpayers without tax agents is set out in Standard Practice Statement SPS 09/03: Extension of time applications from taxpayers without tax agents TIB vol 21:9 (December 2009) at 27-31. The main points of the policy are:

(a) A request for an extension of time by a taxpayer who does not have a tax agent may be made by contacting Inland Revenue either in writing, by secure e-mail or by telephone.
(b) Any request should be made before the due date for filing the return or before the expiry of any existing extension of time arrangement. The late filing penalty may apply if this is not done.
Returns of Income

(c) When deciding whether or not to grant an extension of time, the CIR will take into account the reasons for the request, the taxpayer’s filing history and whether or not any previous extension of time arrangements have been adhered to.

(d) Any extension of time arrangement granted will be for a period that is appropriate under the particular circumstances.

(e) The CIR will notify the taxpayer in writing of the decision that has been made.

(f) A taxpayer 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.

The following are examples of acceptable reasons for allowing an extension:

(a) The taxpayer is unable to obtain the necessary information to complete the return (for example, the taxpayer is waiting for a summary of earnings from Inland Revenue);

(b) The taxpayer has been overseas and needs time to prepare the return (this will depend on the actual dates involved);

(c) Ill health, hospitalisation, or injury of the taxpayer or a family member; and

(d) The taxpayer is awaiting the finalisation of accounts for a related taxpayer/entity with a different balance date.

1270.65 Non-active companies not required to furnish returns [TAA, s 43A]

Non-active companies are not required to file income tax returns or imputation returns, subject to the following conditions.

A company is not required to furnish a return of income for any income year if the company:

(a) Is a non-active company throughout that income year;

(b) Has furnished Inland Revenue with a declaration that it is non-active and that it will inform Inland Revenue if it ceases to be a non-active company; and

(c) Has not ceased to be a non-active company since making the declaration.

A company is a non-active company if, throughout the income year, the company:

(a) Has not derived, or been deemed to have derived, any gross income;

(b) Has no allowable deductions;

(c) Has not disposed of, or been deemed to have disposed of, any assets; and

(d) Has not been a party to or continued with any transactions which, during the income year, give rise to:

(i) Income in any person’s hands;

(ii) Fringe benefits to any employee or former employee; or

(iii) A debit in the company’s ICA account.

A company does not cease to be a non-active company if it:

(a) Incurs statutory company filing fees or associated accounting or other costs;

(b) Incurs bank charges or other minimal administration costs totalling no more than $50 in the income year; or

(c) Earns interest on a bank account, provided the total interest earned during the income year does not exceed the total of the expenses incurred under (b).

Non-active companies that are resident in New Zealand are not required to file imputation returns. If the non-active company has a non-standard balance date, it must be non-active for both income years in which the imputation year falls.
If a company that has made a declaration ceases to be a non-active company, the company must advise Inland Revenue. The company must also provide Inland Revenue with a statement as to:

(a) Whether or not it had any loss carried forward, or any credit balance in its ICA account, at the start of the income year that it became non-active;
(b) Whether or not there has been any change in the ownership (direct or indirect) of the company since that time; and
(c) Whether or not any of the continuity provisions would prevent any net loss or credit balance referred to in (a) from being carried forward, offset or otherwise utilised.

Despite the above provisions, the CIR can require a non-active company to file a return of income or an imputation return.

1270.70 Individuals not required to furnish returns [TAA, ss 33A, 33C]

Most individuals are not required to file an income tax return, and will not automatically receive an income statement/personal tax summary [see 1270.75 Income Statement/Personal Tax Summary], if their only sources of income were interest, dividends, or employment income, provided the income (other than overseas interest or dividends) has had the correct amount of tax deducted at source. If tax has not been deducted, or if it has been incorrectly deducted, from income at source, an individual is still exempted from filing a return if the amount of income incorrectly taxed is $200 or less. The purpose of this is to prevent unnecessary compliance and administrative costs.

An individual is not required to file a return of income provided that:

(a) The person’s income was only of a type listed under “Income types” below; and
(b) The person derived not more than $200 of income of type listed under “$200 limitation” below; and
(c) The individual does not receive employment income from which a tax deduction was made in accordance with a special tax code certificate [see 1080.17]; and
(d) The individual or their spouse [see 960.10] are not issued with a family certificate of entitlement (to interim instalments of family assistance) at any time during the year [see 420.70]; and
(e) The individual or their spouse are not paid a s MD 3 credit for which the family credit abatement [see 420.45], is greater than nil; and
(f) The individual is not issued with a family notice of entitlement for any part of the tax year; and
(g) The individual has a nil Inland Revenue student loan balance on the last day of the year; and
(h) The individual is not eligible to receive a full interest write off under s 38B of the Student Loan Scheme Act 1992; and
(i) The individual is not eligible to receive a base interest write off or reduction under s 39 of the Student Loan Scheme Act 1992; and
(j) The individual derives income from the provision of personal services to a person who is a claimant under the Accident Compensation Act 2001 provided that:
   (i) The person’s total taxable income for the year does not exceed $14,000;
   (ii) Tax has been withheld at the rate of 10.5 per cent from the income derived from the provision of personal services; and
   (iii) The person is not otherwise liable to file a return under s 33A of the TAA [TAA, s 33C].

1) Income types

(a) Income from employment that is subject to PAYE [see 1080.10];
(b) Interest of dividends that are subject to RWT [see 1260.05];
(c) Foreign sourced interest or dividends;
(d) A taxable Maori authority distribution;
(e) A personal service rehabilitation payment under the Accident Compensation Act 2001; or
(f) A source or sources other than those listed in (i) to (iv), if the total amount derived is $200 or less.

(2) $200 limitation
(a) Income in relation to which the individual’s PAYE obligations are not met;
(b) Income in relation to which the individual’s PAYE and student loan repayment obligations are not met;
(c) Income from employment from which the earner premium or earner levy [see 20.20], is not correctly deducted;
(d) Interest or dividends from which RWT is not correctly deducted [see 1260.25] at the rate of:
   (i) 17.5 per cent where the person’s annual gross income is more than $14,000 but not more than $48,000;
   (ii) 30 per cent where the person’s annual gross income is more than $48,000 but not more than $70,000;
   (iii) 33 per cent where the person’s annual gross income is more than $70,000.
(e) Extra pay from which tax is not correctly deducted [see 1080.10];
(f) Secondary employment earnings from which tax is not correctly deducted [see 1080.20];
(g) Dividends, if the individual’s annual gross income is more than $70,000;
(h) Taxable Maori authority distributions, if the individual’s annual gross income is more than $48,000;
(i) Interest, dividends or taxable Maori authority distributions, if the individual is required to pay child support;
(j) Interest, dividends or taxable Maori authority distributions, if the individual has a positive student loan balance and income is in excess of the student loan repayment threshold [see 1380.10];
(k) Salary or wages as an election day worker (if the employee has used the “EDW” tax code);
(l) Salary or wages as a casual agricultural employee (if the employee has used the “CAE” tax code);
(m) Foreign interest or dividends that were subject to a withholding tax at source; and
(n) Portfolio investment entity (PIE) income that is not excluded income [see 1130.40].

Even if the above conditions are met, an individual will be required to file a return (IR3) if the individual:
(a) Is a non-resident [see 1250 RESIDENCE];
(b) Is a provisional taxpayer [see 1140.10];
(c) Is not a cash-basis person [see 470.80];
(d) Received a total of more than $200 of gross income that included:
   (i) A schedular payment [see 1320.10], excluding the amount or proportion of a withholding payment for which the CIR has made a determination [under s RD 8(3)] regarding the expenditure deemed to be incurred in the production of the payment and excluding personal service rehabilitation payments under the Injury Prevention, Rehabilitation and Compensation Act 2001;
   (ii) Beneficiary income [see 1420.55];
(e) Has a research and development tax credit;
(f) Made a net loss; or
(g) Held a RWT certificate of exemption [see 1260.135], at any time in the income year;

There are some exceptions to the requirement for a non-resident to file a return of income. Non-residents who earn $200 or less of salary and wages as a non-resident seasonal worker and who use the “NSW” tax code are not required to file. Non-resident seasonal workers employed under the recognised seasonal
employment scheme are not required to file a return irrespective of the amount earned in that capacity [see 1080.31].

Inland Revenue will not issue an income statement/personal tax summary to an individual who is not required to file an income tax return [see 1270.75]. The effect of (d) above, is that school board trustees are not required to file tax returns if their only source of income is the honoraria paid to them for their services [see 1320.30].

1270.75 Income statement/personal tax summary [TAA, ss 33A, 80A, 80B, 80C, 80D, 80E, 80F, 80G, 80H, 80I, 106]

An income statement and a personal tax summary are the same thing. The ITA 2007 uses the term “income statement” whereas the CIR, in various publications, uses the term “personal tax summary”. This document should not be confused with a “summary of earnings” which is quite different. A summary of earnings merely sets out the information that the CIR holds regarding a taxpayer’s income for the year. This information is gathered from returns from entities such as employers, banks or companies which set out the amount of wages, interest and dividends paid to the taxpayer and any tax withheld at source such as PAYE or resident withholding tax. Requesting a summary of earnings from Inland Revenue does not trigger any tax liability. Requesting an income statement/personal tax summary crystallises the person’s tax position and can result in a refund of tax or a requirement to pay tax where the amounts deducted at source are insufficient to cover the total tax liability for the year.

In the remainder of this paragraph, we have used the term “income statement”. Inland Revenue has the discretion to issue an income statement to any person who derived no income other than interest, dividends and employment income, if the person is:

(a) Exempted from filing a return of income by s 33A(1), but requests Inland Revenue to provide an income statement; or
(b) Exempted from filing a return of income by s 33A(1), but is required by s RD 4(2) to file an employer monthly schedule because the person derived a source deduction payment from which the employer failed to deduct PAYE.

In addition, Inland Revenue may issue an income statement to any person, or require that person to apply for an income statement, where that person has received annual gross income. Inland Revenue may issue more than one income statement to the same individual for the same year.

An income statement must contain the following information:

(a) The amount of annual gross income derived from employment, interest, or dividends;
(b) The sources of the annual gross income;
(c) The amounts of PAYE or withholding deductions made;
(d) The amount of earner premium or earner levy deducted;
(e) A calculation of the income tax liability, including any tax payable or refund due;
(f) Particulars relating to Working for Families (WFF) tax credits (if applicable); and
(g) Any further particulars Inland Revenue consider necessary.

Any individual who receives an income statement when they should not have done so, or who has not received an income statement but should have done so, must inform Inland Revenue on or before the terminal tax date for the income year to which the income statement relates.

An individual to whom s 33A(5) of the TAA applies, and who has not received an income statement, must request an income statement from the CIR no later than the terminal tax date for the income year to which the income statement relates. The following taxpayers are subject to this requirement:

(a) Taxpayers who have received income that has had insufficient PAYE deducted and the “residual income tax” (RIT) is $500 debit or credit;
Returns of Income

(b) Taxpayers who have received income with PAYE deducted that has had insufficient student loan deductions made and the residual repayment obligation is more than $20;

(c) Taxpayers who received more than $200 of interest and/or dividends (excluding amounts that did not require an RWT certificate because the amount paid from the payer did not exceed $50 in the tax year) where Resident withholding tax was not deducted at the rate of:
- 33 per cent where the person’s income was between $48,001 and $70,000, or
- 38 per cent or 39 per cent where the person’s income was more than $70,000;

(d) Taxpayers who received more than $200 of extra emoluments that were not taxed at the rates set out in (c) above;

(e) Taxpayers who received more than $200 of dividends where the person’s income exceeded $70,000;

(f) Taxpayers who received more than $200 of Maori Authority distributions where the person’s income exceeded $48,000;

(g) Taxpayers who received more than $200 of interest, dividends or Maori Authority distributions where the person was required to pay financial support under the Child Support Act 1991;

(h) Taxpayers who received more than $200 of interest, dividends or Maori Authority distributions where the person had a student loan balance as at 31 October 2010 and whose income exceeded $19,084;

(i) Taxpayers who have received more than $200 of secondary employment earnings and these earnings were not taxed at:
- 17.5 per cent where their income was more than $14,000 but not more than $48,000 (21 per cent prior to 1 October 2010);
- 30 per cent where their income was more than $48,000 but not more than $70,000 (33 per cent prior to 1 October 2010);
- 33 per cent where their income was more than $70,000 (38 per cent prior to 1 October 2010);

(j) Taxpayers who received more than $200 as an election day worker and used the EDW tax code;

(k) Taxpayers who received more than $200 as a casual agricultural employee and used the CAE tax code;

(l) Taxpayers who received income that had tax deducted at a rate determined by a special tax code;

(m) Taxpayers who received “Working for Families Tax Credits” (WfFTC) from Inland Revenue during the tax year or are registered for WfFTC and entitled to receive a lump sum payment or who had a spouse with such an entitlement;

(n) Taxpayers who received WfFTC from Work and Income during the tax year and the amount of family credit abatement under s MD 13 of the Income Tax Act 2007 is greater than zero or who had a spouse in that position.

This does not apply to a person who has received interest or dividends with insufficient RWT deducted due to an error made by the payer.

An individual who does not automatically receive an income statement, may request one at any time after the end of the income year.

An individual to whom an income statement has been issued must inform Inland Revenue if the income statement is incorrect and provide the information necessary to correct it on or before the later of:

(a) The person’s terminal tax date for the income year to which the income statement relates; and

(b) Two months after the date the income statement is issued.

An individual does not have to inform Inland Revenue if the total amount of employment income, interest, or dividends omitted from the income statement is less than $200. If Inland Revenue accepts that the information provided by the taxpayer is correct, it will issue a new income statement incorporating the information provided. If Inland Revenue does not accept that all the information supplied is correct, it can either issue a new income statement or an assessment incorporating the information it considers is correct.
Despite the above procedures, if Inland Revenue considers that any of the particulars in an income statement are incorrect it can issue a default assessment. A default assessment will not be issued if the taxpayer informs Inland Revenue of an error in the income statement and provides the information necessary to correct it by the due dates set out above. The tax assessed under the default assessment is payable unless the taxpayer furnishes a return or amended income statement [TAA, s 106(1A)-(1C)].

An income statement issued to an individual is deemed to be a return of income furnished by the individual under s 33 of the TAA [see 1270.10], and to contain a notice of assessment signed by the individual, if the individual accepts it as correct or does not advise the CIR that it is incorrect. The tax position taken in the income statement is deemed to be the individual’s tax position [TAA, s 80G].

A person who is deemed to have made a return by virtue of having received an income statement is also treated as having made an assessment under s 92 of the TAA in respect of that income statement.

The assessment is deemed to have been made on the earliest of:

(a) The person’s terminal tax date for the income year to which the income statement relates; or
(b) The 30th day after the date the income statement is issued, if a refund of less than $200 is due; or
(c) The date on which the person requests a refund under s RM 5.

However, if the income statement is issued less than two months before the person’s terminal tax date, the assessment is treated as having been made two months after the date the income statement is issued. If a person is first issued with an income statement after their terminal tax date, the assessment is deemed to have been made two months after the date of issue of the first income statement, and treated as reflecting the tax position taken in the last income statement issued by the CIR in that two-month period.

In relation to the rules applying to income statements, a statement by the CIR that a return of income is deemed to be furnished, a return of income is deemed to have been signed by a taxpayer, or an assessment is deemed to have been made is conclusive of whether the event has occurred. Such a matter may not be called into question in any challenge or other proceedings on the basis that a return of income has not been furnished, a taxpayer has not furnished a return of income, a taxpayer has not signed a return of income, or the assessment is not final. A matter required to be done or provided within the time limit for furnishing a return of income is deemed to be required to be done or provided within the time limit for responding to an income statement.
Chapter 1290
Royalties

1290.10 Royalties

A royalty derived by a person is income of the person.

A royalty includes a payment of any kind derived as consideration for:

(a) The use of, or the right to use, any copyright, patent, plant variety rights, trademark, design or model, plan, secret formula or process, or other similar property or right;

(b) The use of, or the right to use, a mine or quarry;

(c) The extraction, removal, or other exploitation of standing timber or a natural resource;

(d) The right to extract, remove, or otherwise exploit standing timber or a natural resource;

(e) The use of, or the right to use, a film, a videotape, or a tape in connection with radio broadcasting;

(f) The supply of scientific, technical, industrial, or commercial knowledge or information;

(g) The total or partial forbearance of the use of, or the grant of a right to use, property or a right referred to in any of paragraphs (a) to (e);

(h) The supply of assistance that enables the application or use of anything in any of paragraphs (a) to (f); or

(i) The total or partial forbearance of the supply of knowledge or information or assistance referred to in paragraph (f) or (h).

For the purposes of the above definition, none of the following are relevant:

(a) How the payment is described or computed;

(b) Whether the payment is periodical or otherwise;

(c) Whether the payment is an instalment of the purchase price of real property; or

(d) Whether the payment is an instalment of the purchase price of personal property.

This definition corresponds with international practice, New Zealand’s double taxation treaties, and the policies of the OECD. However, the double tax agreements usually have their own specific definition of “royalty”.

Royalties are:

(a) Deemed to be income [s CC 9];

(b) Deemed to have a source in New Zealand if they are paid by a New Zealand resident and not made in connection with a business they carry on outside New Zealand through a fixed establishment outside New Zealand, or they are paid by a non-resident and for which the non-resident is allowed a deduction [s YD 4(9)]; and
(c) Defined as non-resident passive income and liable for NRWT if paid to a non-resident [subpart RF].

1290.15 **Know-how payments** [s CC 9(2)(f), (h), (i)]

A royalty includes “know-how” payments (ie the supply of scientific, technical, industrial, or commercial knowledge or information).

Payments which are essentially for services are not royalties, except to the extent that the services are connected with the application or enjoyment of “royalties” in the wider sense of the definition (ie the supply of any “assistance” which is furnished as a means of enabling the application or enjoyment of anything referred to in the earlier parts of the definition).

The payment for services may only be taxed in New Zealand to the extent that the services are performed in New Zealand. If the services are performed both in New Zealand and overseas an apportionment will be necessary. Generally, where a double tax agreement is in force a permanent establishment must exist in New Zealand for the services to be taxed here. Reference should be made to the particular agreement [see 310 DOUBLE TAX AGREEMENTS].

1290.20 **Distinction between know-how and services**

The distinction between a payment for “know-how” and a payment for “services” is not always an easy one and much will depend on the facts of a particular case, having regard to the contract or agreement entered into between the parties.

The main distinction between know-how and services is that the former is an asset and, as such, it is something which is already in existence and is not brought into being in pursuance of a particular contract. Thus, if a contract is one for the supply for the use of the “buyer”, of what might be broadly termed here a “product” which is already in existence, or substantially so, it is a contract for the supply of know-how and payments under the contract would be royalties.

On the other hand, if a contractor is required to supply special skills and knowledge in order to bring “the product” into existence for the buyer, payments under the contract would be considered to be for services and would not constitute a royalty.

Inland Revenue provides the following examples for payments made outside New Zealand:

**Example 1:**

A New Zealand resident company, NZ Ltd, manufactures engines under licence from a wholly owned non-resident company, O Ltd. The licensing agreement grants NZ Ltd the right to use patents, trademarks, and unpatented “know-how”. O Ltd agrees to keep NZ Ltd up to date by supplying details of improvements in the engine design etc, developed by O Ltd. In addition O Ltd agrees to give NZ Ltd any assistance necessary to enable NZ Ltd to manufacture the engines successfully. This assistance includes training NZ Ltd’s staff either in New Zealand or overseas, sending specialists to New Zealand to advise and finally receiving a faulty engine from NZ Ltd, diagnosing the fault and supplying NZ Ltd with detailed report. The only payment to be made under the agreement is one of $50 for each engine produced.

The payment falls within the definition of “royalty” and therefore is deemed to be income. Under s RF 2 the royalty will be taxed at the greater of NRWT or income tax on the net income. A 40 per cent arbitrary expense is allowed in the annual assessment. However, a double tax agreement may apply to limit the New Zealand tax. Most New Zealand treaties limit the tax on royalties to 10 per cent.

**Example 2:**

A New Zealand resident company, NZ Ltd, buys a large machine from OS Ltd, an unrelated non-resident company. The purchase price is $100,000. In addition, OS Ltd sends employees to New Zealand to assemble the machine, to ensure it is working properly and to train NZ Ltd’s employees in its use. OS Ltd charges $10,000 for these additional services.

The payment of $100,000 being the purchase price of the machine is exempt. It does not fall within the definition of “royalty”. It is income from business but has no source in New Zealand since it was manufactured overseas. The $10,000 charged for the additional services performed in New Zealand does not fall within the definition of “royalty” but is business income. OS Ltd is therefore assessable, on $10,000 less deductible expenses, at the annual rates applicable to a non-resident company [see PIB No 113 (July 1981)].
Royalties

1290.25 Payments for the supply of know-how and connected services

Typically payments for the supply of know-how and connected services are payments for the supply of technical data such as models, plans, designs, processes, formulas, publicity, instructional, and marketing material together with such services from time to time as are necessary to enable the New Zealand payer to use the know-how. These services can take various forms (e.g., the training either in New Zealand or overseas of the payer’s staff), the sending of specialised personnel to New Zealand to advise on the use of the technical data, the sending of written answers to questions on the technical data issued by the New Zealand payer, etc. The entire payment is treated as falling within the definition of royalty.

1290.30 Payments falling outside the definition of royalties

Payments for the supply of services unconnected with the supply of know-how or royalties and falling outside the definition of royalties, if made to a non-resident, will not be subject to non-resident withholding tax, but this does not mean that they are necessarily not taxable in New Zealand. They may be assessable under s CB 1, which deems all amounts derived from any business to be income. Income from any business wholly or partly carried on in New Zealand is deemed to have a source in New Zealand [s YD 4(2)]. Amounts paid to non-residents in these circumstances may need to be apportioned to exclude the value of any work done outside New Zealand and the balance will be assessed, after deducting allowable expenses, at basic income tax rates. If all the work is done outside New Zealand the income is likely to be non-resident’s foreign-sourced income and not assessable [s BD 1(4), (5)].

Note: Caution should be exercised where two or more agreements are in operation that purport to split the payments into “know-how” and “services unconnected with know-how”. It is likely that either all the services, or part thereof, in the latter agreement are in fact connected with the know-how and are therefore regarded as royalties.

1290.35 Composite payments

It may be claimed that a composite payment is made (either on a royalty basis or as a lump sum) for the use of patents, trademarks, know-how, services connected with know-how, and services unconnected with the transfer of know-how. As a general rule, unless the taxpayer can clearly demonstrate that a significant part of the payment relates to services unconnected with the patents, trademarks, or know-how supplied, the entire payment should be treated as relating to those items. The same applies to cases where the facts are the same except that no patents or trademarks are involved. This approach is supported by the OECD Model Tax Convention on Income and Capital (2008) at 187, in its commentary on royalties:

“In business practice, contracts are encountered which cover both know-how and the provision of technical assistance. One example, amongst others, of contracts of this kind is that of franchising, where the franchiser imparts knowledge and experience to the franchisee and, in addition, provides the franchisee with varied technical assistance, which, in certain cases, is backed up with financial assistance and the supply of goods. The appropriate course to take with a mixed contract is, in principle, to break down, on the basis of the information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to the various parts of what is being provided under the contract, and then to apply to each part of it so determined the taxation treatment proper thereto. If, however, one part of what is being provided constitutes by far the principal purpose of the contract and the other parts stipulated therein are only of an ancillary and largely unimportant character, then the treatment applicable to the principal part should generally be applied to the whole amount of the consideration.”
Paying royalties to an overseas parent company

1290.40 Payments by New Zealand subsidiary company to overseas parent company

A parent company may receive payments from its New Zealand subsidiary, described variously as technical service fees, administrative fees, administration charges, management charges, etc. The exact nature of the payments needs to be established by reference to any relevant contracts or agreements between the two companies and discussions with the companies and, likewise, the basis of computation of the charge. When this has been done the foregoing principles should be applied. The impact of the transfer pricing rules may also need to be considered [see 1000.75].

Payments made back to a parent company or head office may incur a GST charge as a result of the reverse charge rule, which imposes GST on the purchaser of imported services. The reverse charge mechanism applies to persons whose level of taxable supplies is or is expected to be less than 95 per cent of total supplies in a 12-month period. It also applies only to services that would be subject to GST if supplied in New Zealand. The zero-rating provisions [s 11A of the GSTA] do not apply unless the services are physically received at the time and place at which the services are physically performed [see 580.101].

1290.45 Payment for the use of computer software

It is common practice to license the use of computer software rather than sell it. Generally, the licence agreement stipulates that title to the software system stays with the supplier and the right to use cannot be transferred or assigned. The term of the agreement may be indefinite or for periods up to 99 years.

In a licencing situation each payment is likely to a royalty. When it is paid to a non-resident it is subject to non-resident withholding tax. However, the outright sale or assignment of intellectual property does not constitute a royalty.

Inland Revenue has issued an interpretation guideline to assist people in determining whether an amount paid for software is a royalty or a business profit [see TIB vol 15:11 (November 2003) at 8-24]. The interpretation guideline deals with the income tax treatment, under New Zealand domestic law and double tax agreements, of payments made to non-resident suppliers of computer software. It considers the tax implications, for non-resident suppliers, of the most common types of computer software transactions.

In particular, the following transactions are discussed:

(a) A sale of the copyright in a computer program;
(b) A licence of a copyright right in a computer program;
(c) A sale of a copy of a computer program subject to copyright;
(d) A lease of a copy of a computer program;
(e) A supply of services for the development or modification of a computer program; and
(f) The supply of know-how relating to a computer program.

A brief summary of the interpretation guidelines is set out below.

(1) Sale of copyright rights

A sale or assignment of copyright results in the ownership of the copyright rights being alienated either permanently or for a limited period. This alienation of the ownership of the rights means that the consideration derived is not for “the use of the rights” and therefore is not treated as a royalty. This view accords with that of the High Court in DB Group Ltd v Commissioner of Inland Revenue (1996) 17 NZTC 12,446 (HC), which confirmed that a payment for the outright sale of copyright rights does not fall within the definition of “royalty” in s YA 1.

In this situation the purchaser has bought the rights to the copyright as distinct from the “right to use” the copyright.
(2) **Licence of a copyright right**

If a computer software transaction involves the transfer of some but not all the substantial rights in the copyright (i.e., a transfer of partial rights) to a New Zealand recipient, it will generally be a licence. A licence “provides an excuse for an act which would otherwise be unlawful as (e.g. the infringement of a copyright). It is an authority to do something which would otherwise be wrongful, illegal, or inoperative”: per Latham CJ in *Federal Commissioner of Taxation v United Aircraft Corporation* [1943] 2 AITR 458 (HCA), at 464.

A licence to use software copyright generates royalty income under paragraph (a) of the royalty definition.

(3) **Sale of a copyrighted article**

A supply of a copyrighted program (i.e., a copy of a computer program subject to copyright) generally does not include a supply of copyright. The copyright remains with the owner of the original work. The supply of a copyrighted program essentially gives the recipient the right to use the program for personal or business use. This right is separate from a right to use the copyright for commercial exploitation. The sale of a copy of a computer program is analogous to the sale of other copyrighted works such as books and video tapes.

Many software transactions involve some form of end-user licence or user agreement. One common example of this is what is often referred to as a “shrink-wrap” licence. Shrink-wrap licences are generally issued for mass produced software, where the software is sold to an end-user via a distributor.

The licence in such situations generally provides that:

(a) The user acquires a perpetual, non-exclusive, non-transferable licence which authorises the licensee to use the software; and

(b) The licensee is permitted to make back-up copies of the software for operational and security purposes.

The purpose of the licence is to contractually restrict the purchaser from exploiting any of the rights protected by the copyright. The licence is not for the use of, or the right to use, any copyright (as in the case of a reproduction licence), but to prohibit use of the copyright.

From a practical and business perspective, the contract between the parties is for the provision of a copy of a copyrighted article and any transaction involving end-user licences of the nature described above, should be treated as a sale of a copyrighted article.

The purchaser is not paying for the right to use the copyright, and accordingly there is no royalty derived by the non-resident. This approach to prepackaged or shrink-wrap software is consistent with the 1992 OECD Report that considered that the “purchaser has done no more than purchase a product”.

(4) **Lease of a copyrighted article**

If a computer program copy has been supplied for a finite period without accompanying copyright rights in the program, the supply will generate rental income. While not technically a “lease”, as it does not relate to an interest in land, a chattel lease is a contract which, depending on its terms, does create an equitable right of some kind in the subject of the lease: *Bristol Airport plc v Powdrill* [1990] 2 All ER 493 (EWCA Civ), at 502. Payments made pursuant to a chattel lease are referred to in this Guideline as rental payments.

Where parties enter into a transaction for the right to use software for a finite period (as opposed to a right to commercially exploit the copyright rights) then the respective rights and obligations of such a transaction are equivalent to those in a lease. Accordingly, it is the CIR’s view that such transactions be treated equivalently for income tax purposes.

The tax implications of any particular transaction will depend upon the facts of that transaction. In the case of rental payments made in relation to a chattel lease there may be several possible tax implications.

Under sch 4, Part A, contract payments made to non-resident contractors are subject to tax at a rate of 15 per cent. A contract activity includes: “[t]he granting, providing, or supplying of the use, or the right to use, in New Zealand … any personal property …”. Such tax deductions are not a minimum or a final tax liability, but merely a payment on account of the contractor’s annual New Zealand income tax liability.
Payments made may constitute business income of the non-resident “lessor”. Where the non-resident is resident in a country with which New Zealand has a DTA, generally such business income will not be taxable in New Zealand under the business profits article of the applicable DTA, unless the non-resident has a permanent establishment in New Zealand.

Rental payments derived by non-resident “lessors” of computer programs may fall under the royalty articles of New Zealand’s DTAs. Most of New Zealand’s DTAs include, in the definition of the term royalties, payments made “as a consideration for the use of, or the right to use … industrial, commercial, or scientific equipment …”. The CIR accepts that leased computer software will not by itself constitute equipment, but considers that it can be part of equipment, within this royalty definition, where it is an integral part of an identifiable item of industrial, scientific or commercial equipment. The CIR considers that in order to determine whether software is an integral part of an identifiable item of industrial, scientific or commercial equipment, a functionality test should be applied. Where the software is critical or essential to the function of the equipment, ie the software is necessary to enable the equipment to perform its primary function, the software will be an integral part of the equipment.

A hire or lease of a copy of a computer program from a non-resident supplier may also come within the definition of a “finance lease” in s YA 1. Payments made under such leases are subject to the finance lease regime in ss FA 6 to FA 11. Under this regime the finance lease is effectively treated as a sale and loan back transaction, with each lease payment apportioned between a principal repayment and an interest component.

(5) Supply of services for the development or modification of computer programs

For many reasons computer programs may need to be modified, enhanced, or developed over their useful commercial life. Non-residents may be engaged to perform these tasks. Usually the non-resident is supplying a service to the owner or user of the program. However, in some situations the non-resident supplies know-how, and the correct nature of the supply in any situation depends on the facts and surrounding circumstances of the supply and the agreement made between the parties.

A service is generally considered to be some activity that helps or benefits, or conduct tending to the advantage of another, eg professional assistance. The underlying theme of a service is that the provider (supplier) is doing something for the recipient. This view accords with the concept of supplying a service for the purposes of the GSTA 1985: TRA Case S65 (1996) 17 NZTC 7,408.

It is not practical to list all the types of services that can be supplied by a non-resident, but certain indicators may exist that lend support to there being a supply of services. For example, a service is supplied when the benefit of the modification, enhancement, development etc, is for the recipient. Evidence showing that the ownership of the result or product of the service resides with the recipient supports the view that services have been provided. In a similar vein, if the supply involves an additional modification of the computer program and the copyright in the modification resides with the recipient, then this factor also supports a finding that a service has been provided.

In general, payments for the supply of services for the development or modification of computer programs (not connected with a licence of copyright rights or know-how) will be treated as business income of a non-resident supplier. This income will have a New Zealand source to the extent of the value of the services performed in New Zealand under s YD 4, and will therefore be liable to New Zealand income tax.

(6) Supply of know-how relating to computer programs

A payment derived as consideration for the supply of “scientific, technical, industrial, or commercial knowledge or information” (generally referred to as “know-how”) is a royalty under s CC 9(2)(f).

The term “know-how” is difficult to define with any precision. One leading description was given by Lord Radcliffe in Rolls-Royce v Jeffrey (Inspector of Taxes) [1962] 1 All ER 801 (HL). This description has been usefully summarised in Stroud’s Judicial Dictionary of Words and Phrases (5th ed, Sweet and Maxwell) at 1,395 as follows:

“‘Know-how’ is the fund of technical knowledge and experience acquired by a highly specialised production organisation; although it may be, and usually is, noted down in documents, drawings, etc, it is itself an intangible entity whose category may vary according to, and may even be

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determined by, its use. Like office or factory buildings, patents and trademarks, and goodwill, it may be described as a ‘capital asset’ while it is retained by a manufacturer for his own purposes, but, unlike these, its supply to another is not a transfer of a fixed capital asset because it is not lost to the supplying manufacturer (Rolls-Royce v Jeffrey (Inspector of Taxes) [1962] 1 All ER 801 (HL))."

Know-how is an intangible asset and, from a practical perspective, can be viewed as undivulged knowledge or information residing with the supplier that enables the product or process to be replicated. In the computer context know-how can perhaps best be described as information relating to computer programming techniques.

The supplier of know-how always remains entitled to use it: Moriarty (Inspector of Taxes) v Evans Medical Supplies Ltd [1957] 3 All ER 718 (HL), at 735. It is important to distinguish know-how from the physical (or electronic) means by which it is transferred. While know-how may subist in a computer program, that, of itself, does not constitute a supply. In a supply of know-how the seller is passing to the buyer the seller’s special knowledge or information that remains unknown to the public. Accordingly, if the contract between a non-resident supplier and a resident buyer does not purport to transfer the relevant know-how, however it is comprised, the transaction is not a supply of know-how simply because the software has been transferred. In addition, as the know-how is an intangible asset of the seller, who is receiving value from the buyer in exchange for its disclosure, generally know-how will be furnished under conditions which prevent unauthorised disclosure by the buyer.

Payments for know-how do not include payments for services. In practice, however, the distinction between know-how and services is not always easy, and much will depend on the facts of a particular case. As mentioned above, in a know-how transaction the supplier is passing on to the buyer special knowledge or information. In a provision of services, the supplier is not passing on special knowledge or information to the buyer, but is instead using knowledge or information in order to develop, enhance, or modify a computer program. In a sense, the difference between a supply of know-how and a supply of services is that know-how enables the buyer to use the know-how for his or her own benefit, whereas in a supply of services the supplier uses his or her know-how for the benefit of the buyer.

(7) **Summary**

The provision of information with respect to a computer program will be treated as the provision of know-how only if the information is:

(a) Information relating to computer programming techniques;

(b) Furnished under conditions preventing unauthorised disclosure;

(c) Specifically contracted for between the parties; and

(d) Considered property subject to trade secret protection (ie that unauthorised disclosure constitutes a breach of confidence).

The income tax treatment of royalties derived from New Zealand by non-resident suppliers of know-how is the same as that described above for the licensing of copyright rights, except that with a know-how royalty the NRWT of 15 per cent represents a minimum New Zealand income tax only.

1290.55 **Authors’ royalties** [ss CC 9, EI 3]

Royalties paid to authors for the publication of literary works are income [s CC 9]. Royalties do not have tax deducted at source unless paid to a non-resident. Thus the author receives the gross amount of the royalty. An author receiving royalties is not an employee of the publisher. The royalties do not constitute PAYE income payments and therefore PAYE does not apply. Royalties paid to authors are also not schedular payments. Consequently tax is not deducted from royalty payments if paid to New Zealand residents. However, if the author is a non-resident [see 1250 RESIDENCE] the payment would be subject to NRWT at the rate of 15 per cent (unless varied by a double tax agreement) [see TIB vol 6:4 (October 1994) at 3].

Authors receiving royalty payments are responsible for the payment of the tax on that income. Unless the amounts involved are small, authors will be required to pay provisional tax in respect of royalty income.
Royalties

[see 1140 PROVISIONAL AND TERMINAL TAX]. Any expenses incurred in deriving the royalty income will be deductible under the general permission [s DA 1].

When an author is engaged for more than 12 months on the making of a literary work, the income received by the author for the assignment of the copyright or the granting of any interest in the copyright may be spread over the income year in which it is received and the previous income year if the work was made over a period of two years or less; or the two income years before that income year if they made the work over a period of more than two years [see 710.90].

The above rules will apply similarly to royalties paid to authors of dramatic and musical works, and to creators of artistic works.
### Chapter 1300

**Salaries and Wages**

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#### 1300.10  Employment income [ss CE 1, RD 5]

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;
- (b) Expenditure on account of an employee that is expenditure on account of the person;
- (c) The market value of board that the person receives in connection with their employment or service;
- (d) A benefit received under a share purchase agreement;
- (e) Director’s fees;
- (f) Compensation for loss of employment or service; and
- (g) Any other benefit in money.

Section CE 1 is the primary charging provision for income from employment.

**TaxNote:** Not all income from employment is subject to the PAYE rules. To be subject to PAYE deductions, the income must be a PAYE income payment (i.e., salary and wages, an extra pay, or a schedular payment). While most items of income from employment as listed will be subject to PAYE, benefits from an employee share purchase scheme, for example, do not fall into any of these definitions.

#### (1) Salary and wages [s RD 5]

Salary and wages are included within the definition of a PAYE income payment in s RD 3. PAYE income payments are subject to PAYE deduction. Thus, if an item of income is included within the definition of salary and wages it will be subject to PAYE.

“Salary or wages” means a payment of salary, wages, or allowances made to a person in connection with their employment and includes:

- (a) A bonus, commission, gratuity, overtime pay, or other pay of any kind;
- (b) Expenditure on account of an employee;
- (c) A payment to a working partner under s DC 4 [see 1050.65];
- (d) A periodic payment of a pension, allowance, or annuity made to a person or their spouse, child, or dependant in connection with the person’s past employment;
(e) Salary and allowances of a member of Parliament and salary and principal allowances of a judicial officer made under a determination of the Remuneration Authority;

(f) A gratuitous payment made to a person in return for services of the person, or their parent, child, spouse, former spouse, or dependant, where the services were provided to the payer and the payment would not have been made if the services had not been provided;

(g) An income-tested benefit, veteran’s pension, New Zealand superannuation, living alone payment and a basic grant and independent circumstances grant made under regulations made under s 193 of the Education Act 1964 or s 303 of the Education Act 1989, or an enactment substituted for those sections;

(h) A parental leave payment made under Part 7A of the Parental Leave and Employment Protection Act 1987;

(i) The market value of accommodation that the person receives in connection with their employment or service other than a relocation payments;

(j) An amount of an employer’s superannuation cash contribution that an employee chooses to have treated as salary or wages under s RD 68;

(k) An accident compensation earnings-related payment.

“Salary or wages” does not include:

(a) Any amount that is exempt income;

(b) An extra pay;

(c) A schedular payment;

(d) Income which shareholder-employees of a close company choose to have taxed under the provisional tax rules;

(e) An employer’s superannuation contribution other than a contribution that the employee chooses to have taxed under the PAYE rules;

(f) Any payment that is excluded from PAYE under an income tax regulation.

While “extra pay” and “schedular payments” are not salary and wages, an extra pay is included as a PAYE income payment in s RD 3 and subject to PAYE, and schedular payments are subject to their own withholding rules under s RD 8 and sch 4.

(2) Case law

In TRA Case T46 (1998) 18 NZTC 8,311, the Authority ruled that an employee who was granted three years special leave on full pay by his employer to study for his PhD in the US continued to be an employee while overseas and was required to pay tax on his earnings. The payments received from the employer were monetary remuneration (ie employment income), because they were paid in respect of or in relation to the employee’s employment. The payments were not exempt under s CB 9(d) of the ITA 1994 [now s CW 36], because although they amounted to a maintenance or allowance, they were not made in terms of a scholarship or bursary.

In Sayer v Commissioner of Inland Revenue (1999) 19 NZTC 15,249 (HC) the High Court was asked to decide whether some or all of an amount of $100,000 (plus interest) paid to a taxpayer under a deed of settlement and assignment was monetary remuneration. The taxpayer’s former employer (a company in liquidation) owed the taxpayer $130,944 as a result of an Employment Court award of compensation for wrongful dismissal ($62,142), humiliation, loss of dignity and injury to feelings ($50,000), and costs. Under the deed, the taxpayer agreed to waive all future claims against the company and its directors and to assign all existing claims, in consideration of the payment by an undisclosed party of $100,000. Inland Revenue assessed the taxpayer for tax on $50,000, being the part of the payment that it regarded as relating to wrongful dismissal. The Court held that Inland Revenue was not wrong in principal to treat part of the $100,000 as monetary remuneration (ie employment income). The main reason for this decision was the fact that the deed itself provides that $99,999 of the settlement amount is consideration for the assignment by the taxpayer of
the claim for damages for unjustified dismissal. Furthermore, there was insufficient evidence to say that the CIR’s apportionment of the $100,000 between assessable and non-assessable income was wrong.

1300.15 **Expenditure on account of an employee** [s CE 5]

The notion of expenditure on account of an employee was introduced to bolster the FBT regime. Deciding when something is subject the expenditure on account rules or FBT is not always clear. As a rule of thumb, the difference between an amount subject to FBT or taxable as expenditure on account of an employee can be decided by considering where the liability for the expenditure giving rise to the benefit or expenditure resides. If it resides with the employer, then this is a good indication that the FBT rules are applicable, whereas if the expenditure is the employee’s liability, but is met by the employer, then the expenditure on account rules are likely to be applicable.

“Expenditure on account of an employee” means a payment made by an employer relating to expenditure incurred by an employee. Specifically, a premium that an employer pays on a life insurance policy taken out for the benefit of the employee (or their spouse [see 960.10] or their child), unless the policy is excluded under s CE 5(3)(f) to (j). Expenditure on account of an employee is otherwise defined in s CE 5(3) by what is not included.

“Expenditure on account of an employee” does not include:

(a) Expenditure for the benefit of an employee, or a payment made to reimburse an employee, under s CW 17 (Expenditure on account and reimbursement of employees);
(b) An allowance for additional transport costs under s CW 18 (allowance for additional transport costs);
(c) Expenses that an employee pays in connection with their employment or service to the extent to which the expenditure is their employer’s liability, if the employee undertakes to discharge the liability in consideration of the making of the payment by the employer;
(d) Expenditure on an employment-related loan to which the FBT rules apply;
(e) An employer’s superannuation contribution; or
(f) A premium that an employer pays on a life insurance policy taken out for the benefit of the employee (or their spouse or their child) if:
   (i) The premium cannot be refunded to, or converted to cash by, the employee or an associated person; and
   (ii) The only benefits that are payable under the policy are those payable on the death of the employee (or their spouse or their child) or those payable because of accident, disease or sickness of the employee (or their spouse or their child); or
(g) A premium that an employer that is a close company pays on a life insurance policy taken out for the benefit of the employee (or their spouse or their child), to the extent to which the expenditure is treated as dividend under subpart CD;
(h) A premium that an employer pays on a life insurance policy taken out for the benefit of the employee (or their spouse or their child) if the policy is, or is included in, a superannuation category 1 scheme, a superannuation category 2 scheme, or a superannuation category 3 scheme;
(i) A premium that an employer pays on a life insurance policy taken out for the benefit of the employee (or their spouse or their child) if the policy is held by or for the trustees of a superannuation category 3 scheme; or
(j) A premium for income protection insurance that an employer is liable to pay or make a contribution towards for the benefit of an employee.

Expenditure on account of an employee is included within the definition of salary and wages, and as such subject to PAYE deduction.
1300.20  **Accrued employment income** [ss CH 3, DB 51, EA 3(5), EA 4]

Expenditure accrued at the end of the income year for services that have been performed for employment income (eg accrued holiday pay, bonuses, or long service leave), is deductible in the income year that it is incurred, provided it is paid to the employee within 63 days after the end of the income year [see 240.175].

Example:

An employer’s balance date in year 1 is 31 March. At the end of year 1, annual leave worth $15,329 in wages and salaries, remains unused. In year 2 the employees use all their accrued year 1 annual leave. In the first 63 days of year 2 (ie up to 2 June), annual leave equivalent to $4,377 is taken. In year 1, the employer may claim a deduction for $15,329, but the unexpired expenditure of $10,952 ($15,329 – $4,377), must be added back to gross income in year 1 under s CH 3. The employer effectively has a deduction of $4,377 in year 1. The balance of $10,952 may be claimed as a deduction in year 2 under s DB 51 [see 1140.30].

If the employment expenditure is not paid at the end of the 63rd day after the end of the relevant income year, or in the case of shareholder employees, by the last day by which the person could file a return of income for the income year, the unpaid amount is income of the person in the income year under s CH 3.

If an amount is treated as income under s CH 3, the amount qualifies for a deduction in the following income year under s DB 51.

1300.25  **Transfer of provisions for employment income on sale of business** [ss CB 31, DC 10, DC 11, EA 4]

When a business, or part of a business, is sold in an arm’s-length transaction, the deductibility of the employment income provisions is permitted when:

(a) A person (seller) sells a business, or part of a business, to another person (buyer);

(b) An employee of the seller working in the business, or the part of the business, becomes an employee of the buyer under the sale arrangements; and

(c) The seller and the buyer agree in writing, under the sale arrangements, that the buyer assumes the obligation to pay an amount of employment income to the employee.

In these circumstances, provided the seller and buyer are not associated persons, the seller is allowed a deduction, in the income year of sale, for any part of the amount that remains contingent on the employee continuing in employment or any similar factor.

Such contingent income could be for holiday pay, long service leave, retiring allowances or redundancy payments. For example, long service leave is contingent on the employee completing a certain number of years of service. Any liability for such leave is not incurred until such time as the employee has completed that service, even though a provision may have been made for financial reporting purposes.

For the purposes of s EA 4, through s EA 4(4), the contingent remuneration is treated as having been paid, and thus no longer subject to the accrual expenditure rules.

Provisions for actual employment income transferred (such wages that have been earned but not yet paid) are deductible under normal rules because the amounts have been incurred.

Employment income provisions transferred to a buyer on the purchase of a business retain their capital character and are not deductible to the purchaser. For this reason the purchaser will need to account for payments made under those provisions separately from other payments of employment income. For this purpose, the purchaser of a business may account for actual and contingent employment income transferred on an employee by employee basis, or on a group of employees basis. The purchaser must account for the actual and contingent employment income transferred in the same way every year [s EA 4(7)].

If the reduction in consideration (for actual and contingent employment income transferred) paid on the purchase of a business is more than the amount that the buyer actually paid for the obligation transferred, the excess is income of the buyer at the time the provision is recognised as being reduced by generally accepted accounting practice (GAAP) [s CB 31].
If a business is sold to an associated person, the buyer is allowed a deduction for the amount of employment income that the seller would have been allowed as a deduction, had the business, or the part of the business, not been sold. The transferred amounts are not taken into account for the purposes of determining accrual expenditure of the vendor under s EA 4(5).

If employees are transferred to an associated person other than on sale of a business, the new employer may claim deductions for actual and contingent remuneration transferred if the amount would have been deductible to the original employer had the employees not been transferred. The transferred amounts are not taken into account for the purposes of determining accrual expenditure of the vendor under ss DC 10 and EA 4(5).

The term “associated person” is defined in subpart YB [see 70.20].

**1300.30 Restrictive covenants and exit inducement payments** [ss CE 9, CE 10]

Restrictive covenants (golden handcuffs) and exit inducement payments (golden hellos) are specifically dealt with in ss CE 9 and CE 10 and constitutes income.

1. **Restrictive covenants**

A restrictive covenant is income of a person (Person A) if Person A gives an undertaking that restricts, or is intended to restrict, their ability to perform services as an employee, office holder, or independent contractor, whether or not the undertaking is legally enforceable.

There is an exception for restrictive covenants given in the context of the sale of a business, or part of a business if that part can operate separately. The exception applies if:

(a) Person A derived the amount because Person A or an associated person sells a business to another person (Person B);

(b) Person A or the associated person and Person B agree in writing that the transaction is the sale of a business;

(c) Person A derives the amount as consideration for an undertaking by Person A not to provide goods or services in competition with the goods and services that Person B provides from the business; and

(d) Person A does not provide services to Person B after the sale of the business, other than temporarily providing services incidental to the sale.

For the purposes of this exception, the sale of a business includes part of a business.

If the business sold by Person A is incorporated, and instead, all of the shares in the company are sold by Person A to Person B, the exception will apply to the company as though the company were Person B [s CE 9(4)].

2. **Exit inducement payments**

An amount is income if it is derived for:

(a) Loss of vocation;

(b) Loss of a position;

(c) Leaving a position; or

(d) Loss of status.

Restrictive covenants and exit inducement payments are included within the definition of “extra pay” and subject to PAYE if the income was derived in connection with an employment relationship between the person and the person who paid the income.

**TaxNote:** The expression “in connection with” is a very broad term and would include an inducement payment made by an employer to induce and employee to work for that employer, even though there is no actual employment relationship in existence at the time the payment was made.
1300.35 Commutation of salary and pension

Where someone agrees to serve in consideration of a lump sum and no periodical salary, or a small periodical salary, that lump sum is just as much remuneration and taxable as a periodical salary, or as a larger periodical salary would have been: *Prendergast v Cameron* [1940] AC 549 (1940) 23 TC 122 (HL). This person is merely commuting the salary, and a sum so accepted in commutation of salary can in its nature be nothing but salary. The commutation merely substitutes one form of remuneration for another. It is, in effect, remuneration payable in advance and it is fallacious to speak of it as a capital payment. No sum paid as remuneration can ever be capital in the sense that it escapes taxation, since remuneration as such is liable to tax whatever form it takes.

The analogy of cases such as the sale by an annuitant of an annuity is a false one as, in that case, the quality of remuneration is absent from the payment. If a pension is surrendered in consideration of a present payment, with no reference to or connection with present or future services, the sum received is not taxable since it is not remuneration or salary for services. It would be nothing more or less than commutation of a pension, and a pension is in itself a distinct taxable subject matter. An amount received in commutation of a pension is not income, whether made after termination of the service or during the continuance of the service. It does not follow in the latter case that the payment must necessarily be regarded as remuneration for services rendered and to be rendered.

It is, of course, possible for an employee to agree to give up future pension rights in consideration of a present addition to his or her salary, and in that case the addition would be remuneration and taxable as such, notwithstanding that it originated in the surrender of pension rights. The question of whether a sum received in consideration of the surrender of future pension rights is or is not remuneration must depend on the true construction of the agreement by which the transaction is effected. If the sum received is by way of an addition to remuneration, in the form either of an increase in periodical salary or of a lump sum, it is taxable. If it is not so received but is merely paid by way of commutation of a future pension without reference to or connection with the service, it would not be taxable: *Wales (Inspector of Taxes) v Tilley* [1942] 2 All ER 22 (EWCA). Although this case went to the House of Lords and the decision varied slightly, the principles as stated above were not affected by *Tilley v Wales (Inspector of Taxes)* [1943] AC 386, [1943] 1 All ER 280 (HL).

1300.40 Losses from other sources

A salary earner may have other sources of income, such as rents, interest, or dividends. When the deductible expenses in deriving this other income exceeds the income so derived, the person may deduct the loss from the salary income.

1300.45 Sportsperson

A professional footballer receiving a “best and fairest” prize received income as an employee: *Kelly v Federal Commissioner of Taxation* (1985) 16 ATR 478, 85 ATC 4283 (WASC).

While not employment income, it is worth bearing in mind that fees, remuneration, prizes or appearance money received in connection with any activity or sport in connection with any sporting event or competition of any nature, including motor racing, motorcar rallies, motorcycle racing, motorboat racing, and horse racing and trotting, are schedular payments and are subject to a withholding tax of 20 per cent.

The taxation of income from sporting activities is explained in the Inland Revenue Booklet, *The Rule Book* (IR248).

1300.50 Students [s CW 36]

Any scholarship or bursary for attendance at an education institution is exempt income. This excludes a basic grant or an independent circumstances grant under regulations made under s 303 of the Education Act 1989, which are subject to PAYE.

A student allowance does not come within the definition of “salary and wages” and, therefore, does not allow the taxpayer to gain the transitional tax allowance: *TRA Case RI8* (1994) 16 NZTC 6,096.
1300.55 **Awards for lost wages** [s CE 1]

In public ruling BR Pub 06/06 [see TIB vol 18:7 (August 2006) at 17-26], the CIR ruled that the payment by an employer of an award for lost wages or other remuneration under the Employment Relations Act 2000 (ERA 2000) is “employment income” of the employee under s CE 1. Usually the payment is awarded under ss 123(1)(b) or 128 of the ERA 2000, but may be made under another provision. The ruling does not apply to an award of compensation for humiliation, loss of dignity, or injury to feelings made under s 123(1)(c)(i) ERA 2000 [see 1300.60]. The ruling applies for an indefinite period.

The payment is derived by the employee in the income year in which it is received, credited on behalf of the employee, or otherwise dealt with on the employee’s behalf. If the person receiving the payment is a shareholder-employee, the payment is derived in the income year in which the expenditure is deductible to the employer. If the expenditure is not deductible to the employer, the payment is derived in the income year in which it is received by the shareholder-employee.

1300.60 **Payments for humiliation, loss of dignity, and injury to feelings**

[ss CE 1, CA 1]

(1) **Under the Employment Relations Act 2000**

In public ruling BR Pub 06/05 [see TIB vol 18:7 (August 2006) at 9-16], the CIR ruled that payments to employees and former employees that are genuinely and entirely for compensation for humiliation, loss of dignity, or injury to feelings under s 123(1)(c)(i) of the Employment Relations Act 2000 (ERA 2000) are not the income of the employee under s CE 1. Such compensation payments are not gross income under ordinary concepts under s CA 1(2). There is consequently no liability under s RD 17 for employers or former employers to deduct PAYE from these payments. The ruling applies for an indefinite period.

(2) **Under the Human Rights Act 1993**

In public ruling BR Pub 05/12 [see TIB vol 17:6 (August 2005) at 4-11], the CIR ruled that payments for damages or out of court settlements that are genuinely and entirely awarded for humiliation, loss of dignity, and injury to feelings under s 92M(1)(c) of the Human Rights Act 1993 are not income under s CE 1 and are not income under ordinary concepts under s CA 1(2). The ruling applies for an indefinite period.
Chapter 1320

Schedular Payments

1320.10 Schedular payments — a broad definition

The term "schedular payments" was introduced by the PAYE legislation to refer to those classes of earned income where no true master and servant relationship exists. A schedular payment forms part of the recipient’s schedular income and is subject to a deduction of withholding tax. The relevant provisions are located in subpart RD and sch 4 [see 1320.40]. Examples of schedular payments include: commissions; honoraria; fees earned by entertainers, speakers, radio artists, freelance journalists; payments for agricultural work; payments for supply of labour in building and construction work; and payments to non-resident contractors, etc.

The expenditure incurred in deriving schedular income is deductible only where the recipient is not an employee. An “employee” is a person who receives salary or wages. Schedular payments are specifically excluded from the definition of salary and wages. However, where the recipient of schedular payments is an employee, income that may otherwise be classed as schedular payments is salary and wages [s RD 8(1)(b)].

1320.15 Tax code declaration

Any person receiving a schedular payment must complete a tax code declaration (IR330) and deliver it to the person making the payment before the payment is made. The appropriate tax code for a person receiving a schedular payment is “WT” [see 1080.17].

If the recipient of the schedular payment fails to provide the payer with a completed tax code declaration, the payer must deduct tax at one of the following penalty rates:

(a) If neither (b) nor (c) applies, the penalty rate is 15 per cent above the rate specified in sch 4 (eg if the schedular payment rate is 20 per cent the penalty rate will be 35 per cent of the amount of the payment);

(b) If the person receiving the schedular payment is a company that is a non-resident contractor [see 1320.20], the payment is not received directly or indirectly as a result of a choice made to avoid the 15 per cent penalty rate in (a), and the person is not a non-resident entertainer, the penalty rate is five per cent above the withholding tax rate; or
A nil penalty applies if the schedular payment is a payment to a non-resident entertainer. Non-resident entertainers are also able to elect to be a non-filing taxpayer. Where this election is made, the person’s tax liability is equal to the amount withheld.

An individual in business who receives schedular payments may apply for a certificate of exemption, which allows them to receive the payment without the deduction of tax [see 1320.40].

The tax deducted by a payer must be accounted for to Inland Revenue as part of the normal PAYE procedures [see 1080.60 and 1080.65].

**1320.20 Schedular payment — non-resident contractors [ss RD 8, RD 11, RD 19, RD 24, sch 4]**

Withholding tax is required to be deducted from payments to overseas contractors. The rate is 15 per cent of gross payments made to non-residents, whether they are companies or individuals (other than employees), for a contract activity or service. The 15 per cent rate does not apply where another part of sch 4 provides for a different rate for the particular type of income. An example is the 25 per cent rate that applies to payments for media contributions by a freelance contributor. The 25 per cent rate is provided for under sch 4, Part F, cl 1. Therefore, it is necessary to consider all of the categories listed in sch 4 before applying the non-resident contractor rate of 15 per cent. The following flowchart, taken from the Commissioner’s interpretation statement on non-resident contractor schedular payments, sets out the steps to be followed when determining whether a payment is a schedular payment and the applicable withholding rate (if any):
Schedular Payments

Is there a contract, agreement or an arrangement with a non-resident for which payment is made?

Under this contract, agreement or arrangement will the non-resident contractor perform any work in New Zealand?
Or Render a service of any kind in New Zealand?
Or Provide the use of, or right to use, in New Zealand, any personal property or services of a person other than the non-resident contractor?

Is the payment a royalty, under the ITA 2007, which is subject to non-resident withholding tax?

Is the payment a cost reimbursing payment made to a non-associated person?

Is the non-resident contractor eligible for relief under a double tax agreement?

Has the non-resident contractor been present in New Zealand for 92 days or less in any 12-month period?

Is the total amount paid to the non-resident contractor for any 12-month period less than $15,000?

Is the payment for salary, wages or extra pay?

Does the non-resident contractor have a valid Certificate of Exemption?

Does the non-resident contractor have a Special Rate Certificate?

Is an IR 330 held for the contractor with an IRD number?

Deduct non-resident contractor tax at the special rate.

If a company, deduct non-resident contractor tax at the rate provided for in schedule 4 of the ITA 2007 plus add five per cent to that rate; or
If not a company, deduct non-resident contractor tax at the rate provided for in schedule 4 of the ITA 2007 plus add 15 per cent non-resident contractor rate.

Deduct non-resident contractor tax at specific rate provided for in schedule 4 of the ITA 2007; or
If no specific rate then deduct non-resident contractor tax at the 15 per cent non-resident contractor rate.
Schedular Payments

(1) **Interim tax**
The withholding tax is not an additional tax but a payment on account of the non-resident’s annual income tax liability. The tax is neither a minimum nor a final liability. The non-resident’s final tax liability will be determined by annual assessment in the normal way. Any refund or further tax to pay will be determined when the tax return for the year is filed.

(2) **Liable payments**
The withholding tax is required to be deducted from payments to non-residents for any contract activity or service. “Contract activity or service” means:

(a) Performing any work or rendering any service in New Zealand;

(b) Providing the use of, or the right to use, in New Zealand any personal property or services of any person other than the non-resident contractor.

(3) **Exempt payments**
Tax is not required to be deducted from

(a) Direct reimbursement of the non-residents costs, except where the non-resident and the payer are associated persons; and

(b) Royalties within the meaning of the ITA 2007 (but these are subject to NRWT).

Non-resident contractors who are present in New Zealand for less than 92 days in a 12-month period, and are eligible for total New Zealand tax relief under a double tax agreement, are not required to seek a certificate of exemption and are automatically exempted from withholding tax [see TIB vol 15:11 (November 2003) at 25].

(4) **Exemption certificates**
Exemption certificates may be granted, on application from the non-resident contractor, where:

(a) Inland Revenue is satisfied that, by reason of a double tax agreement or for any other reason, the income is exempt from New Zealand tax;

(b) The non-resident contractor provides a bond or other form of security satisfactory to Inland Revenue, securing payment of any tax which is payable or may become payable for the contract activity; or

(c) Inland Revenue is satisfied that the non-resident contractor has complied with all tax obligations in the 24 months immediately preceding the application and will continue to comply in the future.

Payments to non-resident contractors are exempt from withholding tax if the total amount of contract payments made (by all New Zealand employers) to the non-resident contractor does not exceed $15,000 in any 12-month period. A New Zealand employer of a non-resident contractor must be sure, before treating a contract payment as exempt, that the non-resident contractor will not enter into any contracts with other New Zealand employers that might cause the contractor to exceed the $15,000 threshold [s RD 8(1)(b)(iv)].

Example:
If a non-resident contractor contracts with party A for $10,000 in a 12-month period, and in that same period contracts with party B for $20,000, the exemption will not apply. Both party A and party B will be required to deduct non-resident contractors’ withholding tax because the total amount of schedular payments derived by the non-resident contractor exceeds $15,000 in the relevant 12-month period [see TIB vol 15:11 (November 2003) at 25].

The 12-month period referred to is a period of 12 months starting on any date. The application of the exemption for non-resident contractors was clarified in TIB vol 14:5 (May 2002) at 26-27. In particular, the following points should be noted:

(a) The exemption will not apply if the non-resident contractor has a permanent establishment or other fixed base in New Zealand.

(b) Under most double tax agreements, the exemption will not apply if the non-resident contractor is supplying information or equipment the payment for which constitutes royalties.

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(c) The onus is on the employer/payer to ensure that the under-92-day test is met and to determine whether the contract activity is exempt under a double tax agreement. If the employer fails to deduct withholding tax when it should have done, Inland Revenue can recover the tax from the employer. Failure to take reasonable care may also expose the employer to penalties and interest.

(5) **Special rate certificates [TAA, s 24N]**

Inland Revenue can issue, on application from a non-resident contractor special tax rate certificates which authorise a lower or higher rate of withholding tax to be deducted. These amended rates would normally be based on a certified budget of expected revenues and expenditure or on the basis of previous years’ tax returns. Any reduced rate would be for a limited period and would be reviewed in the light of actual results. The withholding tax liability may be affected where a double tax agreement is in force between New Zealand and the country of the contractor’s residence.

(6) **GST and schedular payments**

Where GST applies, the GST is not included when calculating the withholding tax deduction. The payer would hold a tax invoice issued by the supplier (payee) before the withholding tax is calculated on a GST excluded basis.

In *TRA Case U48* (2000) 19 NZTC 9,422, the Authority ruled that payments made by wire transfer to an overseas bank for the hire of shipping containers from a non-resident company, and payments made by telegraphic transfer to an overseas bank for the charter and hire of vessels from a non-resident company, were payments to non-resident contractors and subject to withholding tax under Part E of the Income Tax (Withholding Payments) Regulations 1979.

The Commissioner’s interpretation statement on non-resident contractor schedular payments can be found in TIB vol 22:7 (August 2010).

**1320.30 Schedular payments guide**

The following rules are a guide to some general payments.

(1) **Cleaning or maintenance contracts [sch 4, Part D]**

Payments made to contractors for cleaning or maintaining premises that are not used for farming or agricultural purposes, is not a residential dwelling and is not used exclusively for residential purposes, or for cleaning windows, or for cleaning or laundering plant, vehicles, furniture furnishings, fittings, or equipment are schedular payments and tax should be deducted at the rate of 20 per cent except:

(a) When the contractor is a limited company; or

(b) When the contractor produces a current certificate of exemption (IR118).

(2) **Commission agents other than insurance agents [sch 4, Part B]**

Commission paid to agents, salesmen, canvassers and others working as individuals and remunerated on a commission basis are subject to tax deductions at the time of payment. In order to ensure that the appropriate tax deduction is made, it is necessary to decide whether the commission being paid is essentially salary or wages (for which tax deductions would be calculated from the ordinary tax deduction tables) or a schedular payment (in which case a deduction must be made at the special flat rate of 20 cents per dollar from the gross commission in terms of sch 4).

Whether or not commission is salary and wages depends on the nature of the relationship between the agent and the principal. If the relationship amounts to a contract of service, an employment relationship exists. If the relationship amounts to a contract for services, the commission agent is an independent contractor and the commission will be treated as a schedular payment. The approach to be used when determining the nature of the relationship is set out in TIB vol 4:7 (March 1993) at 2-4 [see 335 EMPLOYMENT RELATIONSHIP].

Tax deductions are not to be made from commissions paid to a company, or to any person who produces a Certificate of Exemption (IR118).
(3) **Directors’ fees [sch 4, Part B]**

Directors’ fees are schedular payments and are liable to have tax deducted at the rate of 33 per cent, unless one of the following exemptions applies:

(a) The director is an employee and the directors’ fees are part of the director’s overall remuneration package. In this situation the directors’ fees would be subject to PAYE. If the director is employed and paid separately for services as a director, the exemption will not apply and the directors’ fees are schedular payments.

(b) The payment of directors’ fees is for services rendered by a public authority, local authority, Maori authority, or company.

(c) The directors’ fees are paid to a partnership for services performed by a partner and the fees are business income of the partnership.

(d) The director holds an exemption certificate issued by the CIR under s 24M of the TAA.

(e) The director is a shareholder employee in a close company and one of the following conditions is met [s RD 3(2)]:
   (i) The shareholder employee does not receive regular amounts of salary or wages for regular periods of one month or less throughout the year; or
   (ii) The total amount or regular payments received is not more that 66 per cent of total income from the company by way of directors’ fees and remuneration for services; or
   (iii) Any amount is paid or credited to or applied on account of the taxpayer by way of drawings against directors’ fees and remuneration for services.

(f) The director holds a special tax code certificate issued under s 24N of the TAA. This certificate will specify a deduction rate different from the standard 33 per cent rate for directors’ fees.

The fact that a director is registered for GST purposes does not release the company paying the directors’ fees from the responsibility of deducting tax. If the director is GST registered and provides the payer with a tax invoice, the payer must make tax deductions from the GST-exclusive amount of the directors’ fees. If the director does not provide the payer with a tax invoice, the payer must deduct tax from the gross amount of the directors’ fees, including any GST charged [see TIB vol 8:4 (September 1996) at 1-3].

(4) **Fees and honoraria [sch 4, Part B]**

These are schedular payments, even where paid exclusively for the personal services of the recipient, unless the payee is also in receipt of a fixed remuneration when these payments might be treated as salary.

Honoraria paid to school trustees are subject to withholding tax at the rate of 33 per cent. The CIR has issued a determination under reg 7 of the Income Tax (Withholding Payment) Regulations 1979 [now s 24P of the TAA], that when a school trustee receives honoraria for attendance at a board meeting, the sum of $55 per member, or $75 for the chair, shall be regarded as expenditure incurred in the production of the payment. The exemption applies to a maximum of 11 meetings per year. If a trustee receives any reimbursement (in addition to honoraria) for expenditure incurred to attend a meeting, the amount exempted under the determination is reduced by the amount of the reimbursement. The determination remains valid until revoked or varied by the CIR [see TIB vol 13:7 (July 2001) at 51-52].

**Example 1:**
The chair receives honoraria of $75 per meeting. No additional reimbursement is received. The school does not have to deduct tax because the payment does not exceed $75.

**Example 2:**
The chair receives a total payment of $95 made up of an honorarium of $70 and reimbursement of travel expenses of $25. The school must deduct tax from $20 ($95 − $75), (ie $20 × 33% = $6.60).

School trustees whose only income is the honorarium are not required to file a tax return. Although the honorarium is a schedular payment, the determination issued under reg 7 of the Income Tax (Withholding
Payment) Regulations 1979 (see above), means that school trustees are not required to file a return [TAA,
  s 33A(2)(d)].

The CIR has issued a determination under reg 7 of the Income Tax (Withholding Payment) Regulations 1979
  [now s 24P of the TAA], that when a member of the Royal New Zealand Plunket Society (Inc) receives
honoria, to reimburse expenditure that the member has incurred in carrying out Plunket-related activities,
up to $600 per annum shall be regarded as expenditure incurred in the production of the payment. If the
Plunket member receives any reimbursement in addition to honoraria for expenditure incurred, the amount
exempted ($600) is reduced by that additional reimbursement. The determination applied to honoraria paid
between 1 April 2002 and 31 March 2007 and has lapsed. It has not yet been reissued.

Example 1:
A Plunket member receives honoraria of $500 in respect of the Plunket-related activities carried out during the year. No other
reimbursement had been paid during the year. The payer does not have to deduct withholding tax because the total payment did
not exceed $600.

Example 2:
A Plunket member receives an honorarium payment of $525 at the end of February. During the year, in May and August, the
member had also received two smaller payments of $100 each as reimbursement of expenses incurred for Plunket-related
activities, making a total of $725 for the year. Because the Plunket member had received reimbursement payments of $200 earlier
in the year, only $400 of the honorarium received in February could be regarded as expenditure incurred under this determination.
Therefore, withholding tax of $41.25 should be deducted from the balance ($125) of the honorarium.

(5) Film industry workers
See 460.65 and 460.67, for tax treatment of payments made to film industry workers.

(6) Suppliers of game and other natural products [sch 4, Part H]
Withholding tax of 25 per cent is to be made from payments to suppliers of game, greenstone, eel, whitebait
and sphagnum moss. Game includes: deer, pigs, and goats which are killed, taken, or captured in a wild state,
and includes payments for meat, tails, sinews, and other parts of the animals.

(7) Insurance commission agents [sch 4, Part G]
The 20 per cent withholding tax is to be deducted on the gross payments whether they are by way of
commissions, retainer, or expense allowance. The agents may claim for actual expenses incurred or 20 per
cent of the gross payments (including any expense allowance which is not separately deductible) where
the agent is self-employed and gross commissions are $5,000 or less in the year.

(8) Insurance industrial agents
The 20 per cent withholding tax is to be deducted on any commissions and retainer paid but not on the expense
allowance granted in terms of the employment contract. The agents must return the gross payments. Where
the agent is self-employed the expense allowance must also be returned as income, but the agent may claim
actual expenses incurred.

(9) Commission on life policies
No tax is required to be withheld from commissions paid by an insurance company to an agent. It makes no
difference whether the insurance is effected on the lives of arms-length parties or on the life on the agent or
members of his or her immediate family [see Public ruling BR Pub 00/02, TIB vol 12:4 (April 2000) at
5-11]. The ruling applied from 1 January 2000 to 31 December 2004. While the ruling has now lapsed, there
is no reason to believe that conclusions do not remain correct. The income of the agent includes commissions
received by the agent on policies on the agent’s own life and on the lives of associated persons. Where the
commissions are offset against the premiums payable on the policies, the amount of the commission retains
its nature as income of the agent [see Public ruling BR Pub 10/07, TIB vol 22:5 (June 2010) at 8-17].
(10) Journalism and illustrations fees for publications [sch 4, Part F]
Fees paid for contributions (including photographs, illustrations and cartoons) by freelance journalists, writers, artists, or other regular or casual contributors to newspapers, magazines, journals, pamphlets, circulars, hand-bills, or similar publications are schedular payments and tax deductions must be made at the source from the gross fees paid at the rate of 25 per cent.

(11) Musicians — members of dance bands, orchestras [sch 4, Part F]
Deduction from payments to musicians will depend on the conditions of their engagement, whether individual or as members of a band or orchestra. There will be some instances of individual employment, eg the members of an established orchestra in which case PAYE applies. Payments in other cases where employment does not exist are schedular payments and the rate of deduction is 20 per cent.

In the cases of the larger bands where the leader is in business and furnishes income tax returns for that business, a certificate of exemption (IR118) may be used. The leader must, of course, make deductions of PAYE or withholding tax (as the case may be) from payments made to musicians involved in the band.

(12) Non-resident contractors [sch 4, Part A]
Payments to non-resident contractors are subject to withholding tax at the rate of 15 per cent.

(13) Non-resident entertainers and visiting sportspeople
See 1000 NON-RESIDENTS AND ABSENTEES.

(14) Piecework
Where the payment is for piecework, or otherwise for work based on production, but is paid solely for the personal services of the recipient (ie is not paid partly to cover the use of plant or equipment, and the recipient does not employ labour), Inland Revenue considers that the payment should be treated as salary or wages. Where the payment is for labour only contractors in the building or construction industry, sch 4 specifically includes such payment as a schedular payment.

(15) Prize money at sporting events [sch 4, Part F]
Prize money paid to participants at sporting events or competitions is liable for withholding tax at the rate of 20 per cent. “Sporting events and competitions” includes (but is not limited to) those involving motor racing, motorcar rallies, motorcycle racing, motorboat racing, and horse racing and trotting. The withholding tax applies to both resident and non-resident entertainers.

When a resident or non-resident entertainer receives prize money from a sporting event or competition, the amount of $500 is regarded as expenditure incurred in the production of the prize money. Thus, withholding tax is only deducted from the amount of the prize money which exceeds $500. If the prize money is equal to or less than $500, the whole of the prize money is regarded as expenditure incurred in the production of that prize money, and no withholding tax would be deducted. This rule applies to each prize paid to participants in an event. If a prize is shared (eg in a tennis pairs competition) the $500 deduction applies to each person’s share of the total prize money [see TIB vol 9:5 (May 1997) at 3].

(16) Salary or wages
Where a fixed remuneration is already payable, any additional payment, whatever its description, should be treated as salary or wages.

Example:
Employee received $500 regular salary and $200 commission in a pay period. The full $700 should be treated as salary. On the other hand, if commission only is receivable, it should be treated as a schedular payment.

(17) Theatrical artists — New Zealand residents [sch 4, Part F]
Where the artists are not employees, fees, remuneration, prize or appearance money, paid for theatrical, stage, concert, or radio performances are treated as schedular payments and tax deductions should be made at the...
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flat rate of 20 per cent. Where the artistes receive their remuneration as salary or wages under a contract of service, PAYE tax deductions, according to the tax codes established, must be made.

Theatrical artists who are independent contractors and receive fees by way of schedular payments can claim actual expenses. If the artistes are on tour they are required to meet their own travelling expenses.

PIB 164 (August 1987) states:

“It is common in licensed premises for performers to be paid out of takings from cover charges collected at the door of the bar in which they are performing. Inland Revenue is satisfied that the licensee or manager of licensed premises is responsible for the deduction of withholding tax from charges made at the door and later handed to the entertainer or entertainers because in terms of the Sale of Liquor Act 1962 the management and control of the premises is vested in the licensee or manager. The licensee or manager is the only person who can restrict entry into any part of the licensed premises. That band members regularly act as doormen and admit or turn away a person, depending on whether that person accedes to paying an entrance fee, is an indication that the licensee or manager is exercising his or her powers under the Sale of Liquor Act. Those persons who collect the door charges or prevent entry by those who do not pay are acting as agents or delegates of the manager or licensees. These persons are therefore collecting the charges on behalf of the management and it is the licensee or manager who in effect, hands the charges to the entertainer. This is the case whether the person collecting the charges is a member of the hotel staff, member of the band, or any other person. The payments handed over to the entertainer or entertainers are specified payments as defined in the Withholding Payments Regulation[s] and the licensee or manager is required to deduct and account for the 20 per cent withholding tax.”

1320.40  Schedular payments [s RD 8, sch 4]

(1) Meaning of schedular payment [s RD 8]
The classes of payments that are schedular payments are those specified in s RD 8. However, the following payments are specifically excluded from the definition of schedular payments for the purposes of the rules:

(a) Payments of salary or wages, or an extra pay;

(b) Payments for work done or services rendered by a public authority, local authority, Maori authority, or company. This does not include a company which is a non-resident entertainer or a non-resident contractor or an agricultural, horticultural, or viticultural company;

(c) Payments covered by an exemption certificate;

(d) Payments made for work done or services rendered by a non-resident contractor, if the non-resident contractor is eligible for total relief from tax under a double tax agreement and is present in New Zealand for 92 days or less in any period of 12 months;

(e) Contract payments made for the contract activities or services of a non-resident contractor, if the total amount of contract payments made for the contract activities to the non-resident contractor, the non-resident contractor’s agent, and any other person acting on the non-resident contractor’s behalf is $15,000 or less in any period of 12 months [s YA 1 for the definitions of “contract payment” and “contract activity or service”].

(2) Exemption certificates [s RD 8(1)(b)(iv); TAA, s 24M]
The CIR may issue any person with an exemption certificate relating to a specific period (eg a tax year). The effect of the certificate is that it authorises the person making the payment (which would otherwise have been subject to a tax deduction) to do so without deducting any tax. An exemption certificate cannot be issued for payments to a non-resident entertainer.

The CIR may, on written application, issue an exemption certificate to a non-resident contractor in respect of a contract activity if:

(a) Any amount derived from the contract activity is not income, either because of a double tax agreement or for any other reason;
(b) The non-resident contractor provides the CIR with a bond or other form of security;
(c) The non-resident contractor has satisfied all their tax obligations in the past 24 months;
(d) The non-resident contractor will satisfy all their future tax obligations.

An exemption certificate may be cancelled at any time by the CIR. A cancelled certificate must be returned to Inland Revenue within seven days of notice of cancellation. An exemption certificate may not be altered or misused.

(3) Amount of tax deduction [sch 4]
The amount of tax to be deducted from a schedular payment is the amount of the payment multiplied by the appropriate rate specified in sch 4, or if applicable, the rate specified in the special tax rate certificate. The tax deduction must be calculated on the gross amount of the payment, even if the payment does not consist entirely of income, and even if the tax deduction relates partly to the income tax liability of an employee or subcontractor. If the payee has provided the payer with a tax invoice, tax is deducted from the gross amount excluding GST.

If the CIR has made a determination, that part of the schedular payment is to be regarded as expenditure incurred, tax is deducted from the net amount.

(4) Media, advertising, and entertainment [sch 4, Part F]
The appropriate rate of tax for payments for work done or services rendered within the class specified in Part F of the sch 4. However, this does not apply if a special tax rate certificate has been issued.

(5) Special tax rate certificates [TAA, s 24N]
The CIR may issue a special tax rate certificate to any person. The certificate may specify:
(a) That a specific amount of tax be deducted from each schedular payment;
(b) That tax be deducted from the schedular payment at a specified percentage; or
(c) That tax be deducted from a specified percentage of the total schedular payment.

The CIR may cancel a special tax rate certificate at any time. A cancelled certificate must be returned to Inland Revenue within seven days of notice of cancellation. A special tax rate certificate may not be altered or misused.

(6) Expenditure incurred in producing schedular payment [s RD 8(3)]
The CIR may determine the proportion of any schedular payment of any class that is to be regarded as expenditure incurred in the production of the payment or payments. This effectively allows the recipient of the payment to receive the benefit of a deduction for expenditure incurred in deriving the income, without necessarily having to file a tax return, and prevents the payment from being overtaxed at source.

(7) Tax to be deducted from protected payments [s RD 8(2)]
Tax must be deducted from a schedular payment even if the payment is protected against assignment or charge.

(8) Non-resident entertainers [s RD 19]
The income derived from New Zealand by a non-resident entertainer consists solely of schedular payments from which tax deductions have been correctly made, the income tax liability of the non-resident entertainer is the total amount of the tax deductions made.

If a non-resident entertainer receives a schedular payment from which no tax deduction was made, the non-resident entertainer must pay the amount of tax that should have been deducted to the CIR by the earlier of:
(a) The 20th of the month following the month in which the tax deduction should have been made; or
(b) The date the non-resident entertainer departs from New Zealand.

The types of activity that are included as schedular payments to a non-resident entertainer are “schedular entertainment activities”. There are activities which meet the requirements of paras (b) and (c) of the definition.
of “non-resident entertainer” in s YA 1. They are any activity or performance undertaken during a visit to New Zealand where that activity or performance is connected with:

(a) A sporting event or competition;
(b) Making speeches or giving lectures or talks for any purpose; or
(c) Acting, singing, playing music, dancing, or entertaining generally.

It includes such activities where they are a solo performance and where they are undertaken along with other people. It does not include an activity or performance relating to:

(a) A cultural programme sponsored by an overseas government or the New Zealand Government;
(b) A foreign foundation, trust or other organisation which exists to promote a cultural activity and is not carried on for the private pecuniary profit of any individual; or
(c) A game or sport where the participants are representing the body that administers the game or sport in an overseas country.

(9) Payments to employees or subcontractors [s RD 20]

If a contractor receives contract payments which are schedular payments, and the contractor is liable to make a payment to an employee or subcontractor, the contractor must deduct tax from the payment to the employee or subcontractor in accordance with the PAYE rules or schedular payment rules (as applicable).

(10) Primary sector employers to provide certain information [TAA, s 24O]

If an employer makes a payment in respect of which a tax deduction is not required to be made because of an exemption certificate [TAA, s 24M] or special tax rate certificate [TAA, s 24N], the employer must provide the CIR with the following information:

(a) The name and tax file number of the employer;
(b) The name of the person who received the payment;
(c) The tax file number of the person who received the payment (if supplied to the employer);
(d) The gross amount of the payment;
(e) The date of the payment; and
(f) The number of the exemption certificate or special tax rate certificate (where applicable).

The provisions apply only where the work performed is “horticultural contract work”. Horticultural contract work is certain types of work or services related to land that is used or intended to be used for agriculture, horticulture, or viticulture. The types of work specified in the definition are:

(a) Pruning or thinning fruit trees or vines; and
(b) Picking or packing fruit or grapes.

The information in item (a) to (f) above, must be provided to the CIR in the employer monthly schedule or, if an employer monthly schedule is not required, by the 20th of the month following the month in which the payment was made.

(11) Schedule 4

Schedule 4 provides the rate at which tax must be deducted from schedular payments. It is broken down into Parts A to I (below).

(12) Payments to non-resident contractors [sch 4, Part A]

A contract payment that relates to a non-resident contractor’s contract activity or service if the payment is to any one or more of the following:

(a) To the non-resident contractor;
(b) To an agent of the non-resident contractor; or
(c) To a person acting on behalf of the non-resident contractor.
Schedular Payments

The rate is 15 per cent.

(13) **Payments of company directors’ fees, examiners’ fees, or honoraria [sch 4, Part B]**

A payment of a company director’s fee, an examiner’s fee, or an honorarium. “Examiner’s fee” means fees or remuneration for work or services that relate to examining an examination candidate, if the work or services have the following nature:

(a) Setting an examination paper or question;
(b) Marking a candidate’s answer;
(c) Examining a candidate orally; or
(d) Examining a candidate’s practical work or performance.

The rate is 33 per cent.

(14) **Payments for work or services relating to primary production [sch 4, Part C]**

A payment for work or services of any one or more of the following types:

(a) Farming contract work;
(b) Cultivation contract work;
(c) Shearing;
(d) Droving;
(e) Forestry or bush work (including bush felling, road and tramway work, removal of timber, undergrowth cutting, burning, or clearing);
(f) Planting or cutting flax;
(g) Work described in ss DO 1 or DO 2 (enhancements to land (except trees), erosion and shelter plantings) that is related to land that is used or intended to be used for farming or agriculture.

“Farming contract work” means work that is related to land that is used or intended to be used for farming or agriculture, if the work is:

(a) Firewood cutting, or post or rail splitting;
(b) Cutting down trees incidental to work under item (a);
(c) Grass or grass seed cutting;
(d) Hedge cutting;
(e) Planting trees;
(f) Planting or cutting flax; or
(g) Threshing, chaff cutting, hay making, hay baling, or harvesting or gathering crops.

“Cultivation contract work” means work or services provided under a contract or arrangement on, or in connection with, land that is used for the cultivation of fruit crops, vegetables, orchards, or vineyards. It includes work or services provided under a contract or arrangement for the supply of labour, or substantially for the supply of labour, in relation to land that is intended to be used for the cultivation of fruit crops, vegetables, orchards, or vineyards.

The restriction to contracts for the supply of labour (or substantially for the supply of labour) takes out payments for services that involve a high capital element such as the provision of large machinery. It does not include work or services provided by a post-harvest facility or by a management entity under a formal management agreement under which the entity is responsible for payment for the work or services provided.

The rate is 15 per cent.

(15) **Payments for commercial cleaning and maintenance work, or for general contracting [sch 4, Part D]**

A payment for commercial cleaning or maintenance. The rate is 20 per cent.
A payment for the following types of work or services.

(a) Mail delivery or collection;
(b) Transporting school children;
(c) Milk delivery;
(d) Refuse removal;
(e) Caretaking or acting as a guard; or
(f) Street or road cleaning.

The rate is 15 per cent.

“Commercial cleaning or maintenance work” means work or services that are related to “schedular commercial land”, if the work or services are:

(a) Cleaning all or part of premises;
(b) Cleaning or laundering plant, vehicles, furniture, furnishings, fittings, or equipment;
(c) Gardening (including grass cutting and hedge cutting);
(d) Destroying vermin; or
(e) Destroying weeds.

“Schedular commercial land” means land that is not:

(a) Used for farming or agriculture purposes;
(b) A dwellinghouse; and
(c) Premises that are used exclusively for residential purposes.

(16) Payments for labour-only building work, or for labour-only fishing boat operating
[sch 4, Part E]

The rate is 20 per cent.

“Labour-only fishing boat work” means work or services under a contract, arrangement, or agreement for profit-sharing which is exclusively or substantially for the supply of labour in connection with operating or maintaining a fishing boat that is required to be registered under s 103 of the Fisheries Act 1996.

“Labour-only building work” means work or services under a contract or arrangement which is exclusively or substantially for the supply of labour in connection with a building or a construction (including pre-fabrication and pre-cutting for the relevant building or construction), if the work or services have the following nature:

(a) Work or services that, customarily, may form part of the work or services of a carpenter under a building contract;
(b) Work or services connected with roof-fixing, steel-fixing, erecting fences, or laying concrete, bricks, blocks, tiles, slabs, or stones, if the relevant building or construction is not land that is used or intended to be used for farming or agriculture;
(c) Work or services connected with hanging wallpaper, hanging decorative wall coverings or furnishings, or painting or decorating (including plastering); or
(d) Work or services connected with installing fibrous plaster, wallboard, insulating material, interior tiles, interior lining, floor tiles, carpet, linoleum, or floor coverings.

(17) Payments for activities related to sports, media, entertainment, and public speaking [sch 4, Part F]

- A payment of a media contribution fee, or of a promotional appearance fee. The rate is 25 per cent.
- A payment that relates to media production work. The rate is 20 per cent unless part A of sch 4 [payments to non-resident contractors] and the fourth and fifth dot points below do not apply to the payment.
Schedular Payments

- A payment of a modelling fee. The rate is 20 per cent.
- A payment for services connected with a non-resident entertainer providing or performing a “Part F activity” if the payment is:
  (a) To the non-resident entertainer;
  (b) To an agent of the non-resident entertainer; or
  (c) To a person acting on behalf of the non-resident entertainer.
The rate is 20 per cent.
- A payment for services connected with a New Zealand resident providing or performing a “Part F activity” if the sixth dot point below does not apply and the payment is to:
  (a) To the New Zealand resident;
  (b) To an agent of the resident; or
  (c) To a person acting on behalf of the resident.
The rate is 20 per cent.
- A payment for services connected with a New Zealand resident providing or performing a “Part F activity” if the payment relates to shares of riding or driving fees and it is:
  (a) To the New Zealand resident who is an apprentice jockey or an apprentice driver;
  (b) To an agent of the apprentice jockey or apprentice driver; or
  (c) To a person acting on behalf of the apprentice jockey or apprentice driver.
The rate is 15 per cent.

“Media contribution fee” means fees or remuneration, paid to a contributor, that relate to a contribution for television, radio, theatre, stage, or printed media.

“Media production work” means work or services that relate to television, videos, or films, if the work or services have the following nature:
  (a) On-set and off-set pre-production work or services;
  (b) On-set and off-set production work or services; or
  (c) On-set and off-set post-production work or services.

“Modelling fee” means fees or remuneration that relate to modelling, including a personal attendance for any promotional purpose, for photography, for supplying personal photographs, or for supplying personal endorsements or statements.

“Part F activity” means an activity or performance that is:
  (a) Connected with any one or more of the following:
      (i) A sporting event or competition;
      (ii) Making speeches or giving lectures or talks for any purpose;
      (iii) Acting, singing, playing music, dancing, or entertaining generally, for any purpose and whether alone or not; and
  (b) Undertaken by a person who meets the requirements of any of the following paragraphs:
      (i) They are not fully or partly sponsored under a cultural programme of an overseas government or the Government of New Zealand;
      (ii) They are not an official representative of a body that administers a game or sport in an overseas country;
      (iii) They are not undertaking an activity or performance under a programme of a foundation, trust, or organisation outside New Zealand which exists for the promotion of a cultural activity and is not carried on for individual profit of the member or shareholder;
(iv) If they are an employee, officer, or principal of a company, firm, or other person, includes the company, firm, or other person.

“Promotional appearance” fee means fees or remuneration that relate to a personal attendance for exhibiting or demonstrating goods.

(18) **Sales commission** [sch 4, Part G]

A payment of commission or remuneration to an insurance agent or sub-agent, or to a salesperson. The rate is 20 per cent.

(19) **Payments to purchase natural products** [sch 4, Part H]

A payment that relates to a purchase of “schedular natural products” if the payment is made to the seller and it is not an “exempt natural products payment”. The rate is 25 per cent.

A payment that relates to a purchase of game if the payment is made to the seller. The rate is 25 per cent.

“Exempt natural products payment” means a payment that relates to the purchase of “schedular natural products”, if the payment is made:

(a) To a natural products dealer;
(b) On a purchase that occurs after a disposal by a natural products dealer;
(c) To an auctioneer or a dealer acting as agent for the seller; or
(d) At retail, in a shop.

“Game” means all or part of a wild deer, wild pig, or wild goat, whether dead or alive.

“Natural products dealer” means a person who:

(a) Is registered under any Act or regulation as a broker, dealer, or trader in relation to schedular natural products;
(b) Holds a natural product dealer certificate, issued by the Commissioner under s 44D of the Tax Administration Act 1994; or
(c) Holds an unrevoked certificate from the Commissioner showing that the person would be a licensed dealer for purposes of the Income Tax (Withholding Payments) Regulations 1979 (prior to their repeal).

“Schedular natural products” means any one or more of the following:

(a) Greenstone (nephrite);
(b) Eel;
(c) Whitebait;
(d) Sphagnum moss.

(20) **Personal service rehabilitation payments** [sch 4, Part I]

A personal service rehabilitation payment for a person under the Accident Compensation Act 2001. The rate is 10.5 per cent.
Chapter 1340
Share Sales

1340.10 Holding shares
Shares are personal property. An ordinary investor buys shares for three basic reasons:
(a) To secure an income from the dividends;
(b) To hold as a hedge against inflation;
(c) To secure growth in capital invested.
These circumstances generally apply to all ordinary investors who may own several parcels of shares in different companies and, from time to time, sell them in line with changes in portfolio policy. However, such sales are not necessarily taxable. Profits or gains from the sale or other disposition of shares are assessable only if one or more of the following applies:
(a) The profits or gains are derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit [s CB 3];
(b) The shares that were sold were acquired for the purpose of selling or disposing of them [s CB 4]; or
(c) The business of the taxpayer comprises dealing in shares [s CB 5].
The Courts have stated that it is the dominant purpose at the time of buying the shares that is relevant. If a taxpayer has entered into any undertaking or scheme for the purpose of making a profit from shares, the profits will be taxable. Thus, profits which arise from motives of speculation or dealing are assessable.
Where the owner of an ordinary investment chooses to realise it, any gain is not normally a taxable profit. However, it is taxable when securities are realised in the course of carrying on a business: Californian Copper Syndicate v Harris (1904) 5 TC 159.
In Commissioner of Inland Revenue v Rangatira Ltd (1995) 17 NZTC 12,182 (CA) the Court of Appeal found that profits on the sale of the shares were business profits, but this was reversed by the Privy Council in Rangatira Ltd v Commissioner of Inland Revenue [1997] 1 NZLR 129, (1996) 17 NZTC 12,727 (PC).
In TRA Case S8 (1995) 17 NZTC 7,062, shares in a subsidiary company were sold to a company in another corporate group, at a price considerably in excess of their true value. The sale was part of a tax saving scheme. The profit resulting from the sale was held to be non-assessable because the transaction was not part of the normal business of the company.

1340.20 Purpose of disposal
A profit on an isolated speculation in shares is assessable. The law looks at each individual parcel of shares sold during the year and at the purpose for which those shares were acquired [see 710.70]. Conversely, any losses are deductible, but the onus is on the taxpayer to show clearly that the transaction was a speculation and not an investment. The ordinary investor in shares is not normally liable for tax on any profit made on
the sale of shares. The mere fact that the shares were acquired with a view to growth in their value would not in itself make any profits assessable.

No deduction is available for unrealised losses on shares acquired for the purpose of resale.

In *National Distributors Ltd v Commissioner of Inland Revenue* (1987) 9 NZTC 6,135 (HC), the High Court considered the applicability of the legislation to a private company where the prime activity was leasing. Purchases of shares were made for long term investment purposes and their haphazard sale, although involving intermittent monitoring of the market and achievement of favourable results, were a normal process of asset management. There was no carrying out of an “undertaking” or “scheme”, there being no evidence of design or planning with a definite end in contemplation. However, on appeal in *Commissioner of Inland Revenue v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA), profits derived on share sales were held taxable on the basis that they had been acquired for the purpose of sale or disposal.

The taxpayer was assessable on profits from the sale of six groups of shares which had been held for an average period of 16 months. Shares acquired for resale but not sold at the end of the year are not taken into account, until actually sold in a later year: *TRA Case M115* (1990) 12 NZTC 2,737, (1990) 15 TRNZ 188.

In *TRA Case M115* (1990) 12 NZTC 2,737, (1990) 15 TRNZ 188, the taxpayer was assessable on profits from the sale of six groups of shares which had been held for an average period of 16 months. Any increase in the value of shares acquired for resale but not sold at the end of the year is not taken into account until the shares are actually sold.

In *Plimmer v Commissioner of Inland Revenue* [1958] NZLR 147 (SC), the taxpayer purchased a large parcel of both ordinary shares and preference shares. The reason for the acquisition was to secure for the taxpayer a controlling interest in the company. As the ordinary shares gave the taxpayer control of the company, he resold the preference shares which he had been forced to acquire as a condition of the purchase. The Court held that the profits were not assessable and that the taxpayer’s purpose was to obtain control of the company.

See also *Commissioner of Inland Revenue v Renouf Corporation Ltd* (1998) 18 NZTC 13,914 (CA), summarised in 875.30.

In *TRA Case B19* (1975) 2 NZTC 60,145, (1975) 1 TRNZ 269, the business of an investment company comprised lending money on first mortgage. Occasionally, small sums unsuitable for lending on mortgage were temporarily invested in shares until required for mortgage advances. The shares were selected for maximum yield rather than capital appreciation. Profits were made on the sale of the shares, and the court was asked to decide whether the company was a dealer in shares, and whether the shares were acquired for the purpose of sale. It was decided that, with one exception, the dominant purpose of the taxpayer at the time the shares were acquired was to resell them at such times as the funds were required for mortgage investment. Therefore, the profits were taxable in terms of the second limb of s 88(1)(c) of the Land and Income Tax Act 1954 [now s CB 4]. An exception applied to 200 bonus shares which were acquired when a merger was effected that was not anticipated when the shares were acquired. Whether a taxpayer is taxable on the sale of shares involves the making of a wide survey and an exact scrutiny of the taxpayer’s activities. The criteria to be taken into account include the nature of the asset, the circumstances of the purchase, the vocation of the taxpayer, the number of like transactions into which the taxpayer has entered in relation to the total invested capital, the length of time the property was held, and the circumstances of its sale.

### 1340.30 Dealing in shares

If a person is a dealer in shares, profits are assessable and losses are deductible against other income and able to be carried forward for set off against income of later income years.

It is a question of fact whether a taxpayer was carrying on a business of dealing in shares, and whether the items bought and sold were part of the business: *TRA Case N12* (1991) 13 NZTC 3,088, (1990) 15 TRNZ 557.

**1 Valuation at balance date**

A share dealer is required to value shares on hand at balance date according to the trading stock rules. These rules require shares to be valued at cost using either the FIFO or weighted average method. Shares may be
valued at nil where they have no current or likely future market value and have been written off as worthless by the taxpayer [see s ED 1 and 1400.60 EXCEPTED FINANCIAL ARRANGEMENTS].

(2) Fixed or circulating capital

In Commissioner of Inland Revenue v Inglis (1992) 14 NZTC 9,180 (CA) and Commissioner of Inland Revenue v Stockwell (1992) 14 NZTC 9,190 (CA), the Court referred to the distinction between fixed capital (which is capital invested in revenue producing assets) and circulating capital (which is capital invested in trading stock) and considered that a loss of capital is not prohibited from a deduction if it is circulating capital.

1340.40 Share losses [s DA 1]

Expenditure is deductible if it is incurred in deriving assessable or excluded income. Where the expenditure incurred in acquiring shares exceeds the proceeds for the sale of those shares, any resulting loss is available for offset against other income. Taxpayers claiming such losses must demonstrate that the sale of the shares is assessable. This basic principle arises whether the shares have been held for reasons of speculation, investment or dealing in a business.

Two cases, Inglis and Stockwell, have ruled in favour of taxpayers by finding that losses on the sale of shares can be deductible even where the taxpayer is not in the business of share trading. The taxpayers had purchased shares with the purpose of resale. The CIR did not dispute that if profits had arisen that they would have been taxable under s 65(2)(e) of the ITA 1976 [now s CB 5].

The following information for each share sale is expected when claiming losses on share transactions:

(a) Name of the company;
(b) Number of shares sold;
(c) Date of purchase;
(d) Date of sale;
(e) Cost of shares sold (including brokerage);
(f) Sale price of shares (net after brokerage);
(g) Other expenses (eg interest);
(h) Profit or loss (if claiming a loss state also the details of profits made from previous sales whether in this tax year or in earlier years); and
(i) Explain also the purpose for which the shares were purchased.

1340.50 Losses on disposal or non-disposal of shares by company [s DB 24]

Under certain circumstances, companies are prohibited from taking a deduction for losses arising from the sale or downward revaluation of shares. The prohibition applies where the amount subscribed for the share is used in such a way that a net loss results and that loss is able to be offset against the income of the shareholding company.

The share loss is not prohibited to the extent to which it exceeds the revenue loss accessed by way of loss offset.

Were it not for this provision, the investing company would be able to access a double deduction; one by way of the loss offset and the other by way of the resulting reduction in the value of the shares in the loss-making company.

1340.60 Sale of rights

Where a company confers upon its shareholders a right to purchase further shares at a price below market value, the sale of the rights by a shareholder, who is an ordinary investor and not a dealer in shares, does not represent income for tax purposes: Palmarc Investments Pty Ltd v Federal Commissioner of Taxation (1985) 16 ATR 671, 85 ATC 4410 (NSWSC).
1340.70 Shares sold cum div
Where shares are sold “cum div”, the purchaser is entitled to the imminent dividend. The dividend represents income to the purchaser, even where the sale takes place after the declaration of the dividend. The total sum is received by the vendor on capital account.

1340.80 Dividend stripping [ss CD 11, GB 1]
“Dividend stripping”, refers to an arrangement under which dividend income is diverted to a taxpayer who has a low tax rate, is tax exempt or has unutilised tax losses. This is achieved by selling shares in a company, which has substantial retained profits, at a price that includes its dividend potential.

In order for the provision to apply, the following three circumstances must exist:
(a) Shares are sold for a consideration under a tax avoidance arrangement;
(b) Tax avoidance is a purpose or effect of the arrangement; and
(c) The consideration includes amounts that would otherwise have constituted dividends in that or future income years.

Where these circumstances are found to exist, the amount received in substitution for the dividend is assessable.

In Federal Commissioner of Taxation v Gregghon Investments Pty Ltd (1987) 19 ATR 457, 87 ATC 4988 (FCA), a dividend strip was held to have occurred where a company’s shares were transferred at net asset value less a commission and the business assets of the company were by a series of transactions ultimately transferred to a company under the control of the shareholders of the vendor company. The purchaser company then operated the business in substantially the same manner as had the vendor. This situation was distinguished from that of Slutzkin v Federal Commissioner of Taxation (1977) 7 ATR 166 (HCA) in which no dividends strip was held to have occurred.

In Slutzkin, the vendor company had been dormant and there was no intention by the purchaser company to carry on the previous business. Thus, no artificiality was held to have occurred.

1340.90 Share-lending transactions [ss CD 17, CD 18, CD 54, CH 1, CX 54, DB 16, DB 17, DB 49, EA 1, ED 1, ED 2, EW 5, EW 52, GB 30, GB 49, GC 1, LB 3, LE 1(2), LF 1, LF 7, OB 22, OB 50, OB 64, OP 15, OP 39, OP 40, OC 11, OC 17, OP 60, OP 65, RE 2, RE 7, RE 11, RE 17, RE 19, RE 21, RE 25, sch 1; TAA, ss 30B, 30C]
Share-lending occurs when one party lends shares to another for a fee. The transaction may be entered into by brokers where they have a shortfall or by finance organisations to increase their overall portfolio returns. Legally, the transaction constitutes a sale and buy-back of the share with the normal tax consequences resulting. However, specific share-lending rules provide for the taxation of qualifying share-lending transactions on the basis of economic substance rather than legal form. Anti-avoidance rules apply to non-qualifying transactions.

A qualifying share-lending arrangement involves a “returning share transfer” which is an arrangement where all of the following apply:
(a) A share (the original share) which is listed on an official list of a recognised exchange is transferred from a share supplier to a share user;
(b) It is agreed that the share user or associate [s YB 2] will pay a replacement payment to the share supplier (or associate) in the event that a dividend is payable on the original share during the term of the arrangement;
(c) It is agreed that either the original share or an identical share may be transferred from the share user to the share supplier or associate [s YB 2; and
(d) The arrangement is not a warrant or instalment receipt.
Provided that certain criteria are met, a “returning share transfer” will fall within the definition of a “share-lending arrangement” and no taxable disposal will arise from the transaction. A “share-lending arrangement” is a returning share transfer:

(a) Entered into on or after 1 July 2006 for a term of one year or less;
(b) The arrangement is on ordinary commercial terms consistent with those that would apply between arms’ length parties;
(c) Any resident withholding tax payable under s RE 17 is paid;
(d) The share user disposes of either an original share or an identical share during the course of the arrangement (or within such further time as the CIR may allow); and
(e) If a dividend is payable on the original share, the share user either establishes and maintains an imputation credit account or issues a credit transfer notice in relation to the dividend.

The last of these criteria is designed to ensure that the benefit of any imputation credit attached to a dividend paid on the share during the course of the arrangement remains with the owner of the share.

Where a share user or associate receives an imputed dividend under a returning share transfer that does not meet the definition of “share-lending arrangement” the benefit of the imputation credit is cancelled out by way of a debit to the share user’s imputation credit account. In addition, the transfer of the share is treated as a disposal of the share for tax purposes.

Any share-lending collateral derived under a share-lending arrangement is excluded income. Share-lending collateral is a market-value related amount that is paid by a share user to secure the transfer of the original share [s CX 54].

A share-lending arrangement is an excepted financial arrangement [s EW 5(12)]. Neither the rules relating to disposition of trading stock for inadequate consideration [s GC 1] nor the rules relating transfers of financial arrangements between members of the same wholly-owned groups of companies [s ED 2] applies to share-lending arrangements.

Sections CH 1 and DB 49 provide for a share-lending right to be valued at the cost price of the original share for the purposes of accounting for the opening and closing values of excepted financial arrangements. This ensures that there is no change in the value of revenue account property. The share user is not allowed a deduction for the cost of acquiring the borrowed share and is not taxed when the share is returned [s DB 16].

If a distribution is paid on the original share during the term of the arrangement, the share user must make a replacement payment to the share supplier. This is an amount which is economically equivalent to the dividend paid on the share. The replacement payment is income of the recipient [s CD 54] and deductible to the to the payer [s DB 17]. The deduction includes the amount of any imputation credits attached to the replacement payment [ss OB 64, RE 25].

The share user may choose to pay the cash amount of the dividend along with any imputation credits attached, or may choose to pay a cash amount equal to the sum of the two amounts. If there are insufficient imputation credits, resident withholding tax must be paid [s RE 25]. Imputation credits can also be transferred to the share supplier by way of a credit transfer notice [TAA, s 30C]. The amount transferred is income of the share supplier and is not income of the share user [s CD 17].

A detailed analysis of the share-lending rules can be found in TIB vol 18:5 (June 2006) at 86-94.
Chapter 1350
Shipping and Seafaring

1350.10 Taxation of shipping profits [ss CV 16, YD 4, YD 6]
Income derived from the carriage by sea or air of merchandise, goods, livestock, mails or passengers shipped or embarked in New Zealand is deemed to have a New Zealand source [s YD 4].
The income of non-resident shipowners which is deemed to arise in New Zealand from shipping freights and passage money is five per cent of the gross outward freight and fares [s CV 16].
Any merchandise, goods, livestock, mails or passengers shipped or embarked on any ship at any port in New Zealand for carriage outside New Zealand are deemed to be carried outside New Zealand, even though the ship may call at one or more other ports in New Zealand before finally leaving on its voyage overseas.
The CIR may exercise a power to treat as excluded income (and therefore not subject to tax), the New Zealand sourced shipping profits derived by non-resident shipowners where a reciprocal exemption is provided in similar circumstances to resident shipowners from foreign jurisdictions [s YD 6].
The current jurisdictions where the exclusion applies are:
• Barbados;
• Bermuda;
• Brazil;
• Chile;
• Greece;
• Hong Kong;
• Israel;
• Liberia;
• Netherlands Antilles;
• New Caledonia;
• Panama;
• Papua New Guinea;
• Poland;
• Tonga;
• Vanuatu.
This exemption applies to shipping profits only and not to the New Zealand tax on income derived from other sources in New Zealand.
(1) Salvage proceeds
Salvage money is part of the reward of seafaring and is income. The cost of salvage is deductible, except where the salvage proceeds are derived by the crew who participated in the rescue operation for their employment or services. A payment made to a volunteer crew in addition to overtime rates was deemed to be income from employment rather than a gift: Naismith v Commissioner of Inland Revenue (1981) 5 NZTC 61,046, (1981) 4 TRNZ 300 (HC).
(2) Non-resident crew members
Amounts derived by a crew member of a pleasure craft are exempt under certain circumstances [see 370.15 (Exemptions under the ITA 2007)].
Chapter 1360

State Organisations and Local Authorities

1360.20 State organisations generally exempt [s CW 38]

In general, public authorities such as state departments and state corporations are not liable for taxation. However, there are important exceptions. These include:

(a) The Public Trustee;
(b) Any “State enterprise” specified in sch 36 [see 1360.40];
(c) Any Crown Research Institute [see 1360.60];
(d) Any authority to the extent to which it is a superannuation scheme;
(e) Any amount that a Public Authority derives as a trustee.

1360.30 Local authorities generally exempt [ss CW 10(3), CW 39, CW 40, CW 41, CW 42]

Local authorities are subject to tax on their commercial undertakings in the same manner as other commercial taxpayers.

For tax purposes, “local authority” is defined in s YA 1 to mean:

(a) A local authority within the meaning of the Local Government Act 2002; and
(b) Includes the:
   (i) Administering body within the meaning of the Reserves Act 1977 of any reserve classified under that act as a scenic reserve or recreation reserve;
   (ii) Airport authority (other than an airport company) within the meaning of the Airports Authorities Act 1966;
   (iii) Aotea Centre Board of Management;
   (iv) Canterbury Museum Trust Board;
   (v) Council of the Auckland Institute and Museum;
   (vi) Otago Museum Trust Board;
   (vii) Auckland Regional Transport Authority;
   (viii) Auckland Regional Holdings (other than for the purposes of the exclusions in item (a) and (b) below).

Any amount derived by a local authority is exempt from income tax (under s CW 39) other than income that is comprised of one or more of the following:

(a) An amount received in trust;
(b) An amount (other than rates) derived by a local authority from:
   (i) Any council-controlled organisation, unless it is operating a hospital as a charitable activity on behalf of the Local Authority;
(ii) Any energy company, port company or subsidiary of a port company, or energy company that would be a “council-controlled organisation” in the absence of s 6(4) of the Local Government Act 2002; or

(c) An amount derived by a port operator, to the extent to which it relates to a port-related commercial undertaking.

The exemptions under ss CW 40 (local and regional promotion bodies), CW 41 (charities: non business income), and CW 42 (charities: business income) do not apply to council-controlled organisations or to local authorities in respect of income derived from a council-controlled organisation other than a council-controlled organisation operating a hospital as a charitable activity on behalf of the Local Authority.

The dividend exemption for dividends derived by a company from another company within the same wholly-owned group does not apply where the dividend is derived by a local authority from any council-controlled organisation, energy company, port company or subsidiary of a port company [s CW 10(3)].

A “council-controlled organisation” is defined in s YA 1 to mean:

(a) Any company that is a council-controlled organisation under the definition contained in s 6(1) of the Local Government Act 2002;

(b) Any organisation, other than a company, that is a council-controlled organisation;

(c) Any council-controlled organisation which has, in relation to another council controlled organisation:

(i) Control of 50 per cent or more of the votes at any meeting of the members or controlling body of the organisation;

(ii) The right to appoint half or more of the trustees, directors or managers of the organisation;

(d) New Zealand Local Government Association Inc;

(e) A company or organisation controlled by the New Zealand Local Government Association Inc;

(f) New Zealand Local Government Insurance Corporation and its subsidiaries;

(g) Watercare Services Ltd and any of its subsidiaries;

(h) Any organisation that would be a council-controlled organisation under (a), (b) or (c) above were it not for an exemption granted under s 6(4)(i) of the Local Government Act 2002.

The definition specifically excludes the Auckland Regional Transport authority.

1360.40 State enterprises [s YC 5]

Schedule 36 lists the State enterprises for income tax purposes as follows:

- AgriQuality New Zealand Ltd;
- Airways Corporation of New Zealand Ltd;
- Asure New Zealand Ltd;
- Crown Forestry Management Ltd;
- Electricity Corporation of New Zealand Ltd;
- Genesis Power Ltd;
- Government Property Services Ltd;
- Housing New Zealand Corporation;
- Housing New Zealand Ltd;
- Landcorp Farming Ltd;
- Learning Media Ltd;
- Meridian Energy Ltd;
- Meteorological Service of New Zealand Ltd;
- Mighty River Power Ltd;
- New Zealand Post Ltd;
- Quotable Value Ltd;
- Radio New Zealand Ltd;
State Organisations and Local Authorities

- Solid Energy New Zealand Ltd;
- Television New Zealand Ltd;
- Terralink New Zealand Ltd;
- Timberlands West Coast Ltd;
- Transpower New Zealand Ltd;
- Works and Development Services Corporation (New Zealand) Ltd.

The offset of losses between State enterprises, or other transactions between related parties which have tax advantages, are unable to be used by State enterprises despite their having a common shareholding by the Crown. This is due to the fact that the holder of the shares is deemed under s YC 5 to hold nothing other than rights in respect of the particular State enterprise.

1360.50 Airport operators [ss DW 1, HR 1(4), HR 5, HR 6, HR 7; TAA s 42]

The general provisions of the tax legislation apply to airport operators except where they conflict with specific provisions.

An airport operator is deemed to be a company carrying on the business of operating an airport. The income of an airport operator is assessable. An airport operator means the Crown and an airport authority acting as parties to an airport joint venture agreement. Airport operators are deemed to be separate persons and not to be public or local authorities. This ensures that the income of airport operators is not presumed to be exempt income on the basis of it being a public authority. The activities of the airport operator include establishing, improving, maintaining, operating or managing an airport including the approaches, buildings, equipment for the airport. The airport operator is deemed to own all of the assets which are airport assets.

The parties to a joint venture agreement are deemed to hold shares in the airport operator in the same proportions as profits, after taking into account any adjustments for previous years, are to be shared between the parties.

For an airport operator, “airport asset” are those assets that any one or more of the following applies:

(a) An asset that, under the joint venture agreement, the airport authority acquires, agrees to use or is given the power to use for the purposes of the airport operator’s activities;
(b) An asset owned for the purposes of a depreciation sinking fund for an airport asset;
(c) An asset owned for the purposes of a loan redemption sinking fund for a loan on which the interest payments are a charge against the joint venture income of the airport operator; or
(d) An asset acquired by the airport operator using funds or property that acquired in carrying on the airport operator’s activities and not allocated or distributed to the joint venturers.

Funds are deemed to be borrowed as capital employed by the airport operator and a provision in the nature of interest on those funds is deemed to be deductible as expenditure or a loss in the nature of interest where all of the following apply:

(a) The airport operator has the use of funds provided by one of the parties to the joint venture agreement;
(b) It was expressly agreed, in writing, that those funds were advanced for the purpose of activities as an airport operator; and
(c) The funds were provided in consideration for some provision in the nature of interest.

No deduction is available to an airport operator for any expenditure or loss incurred, or deemed to have been incurred, by an airport authority and chargeable against profits that have been distributed to the joint venture parties. The intention is that no deduction be available for expenditure chargeable against the Airport Authority Appropriation Account or the Crown Appropriation Account.

There is no need for the Crown and the airport authority to file a joint or partnership income tax return. An airport operator, being deemed for income tax purposes to be a company and a separate person, is required to file a separate IR4 income tax return. Income tax files for airport operators are held at the Special Companies Section of Inland Revenue’s Wellington District Office.

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1360.60  **Crown Research Institutes** [ss CV 6, CW 49, OB 1]

The income of the Crown Research Institutes is assessable in the same way as State enterprises, statutory producer boards and other statutory bodies. The s CW 41 exemption for income derived by an organisation established to promote scientific or industrial research does not apply to Crown Research Institutes. A Crown Research Institute is a “special corporate entity” which means that its shares are deemed to be held by the same single person. This results in it being unable to group with any other entity. It also results in no breach of shareholder continuity being possible. Crown Research Institutes are prohibited from maintaining an imputation credit account.

1360.70  **Government Superannuation Fund Authority** [s HR 4]

The Government Superannuation Fund Authority is liable for tax as if the Fund were a superannuation scheme that is a trust, and the Authority were trustees.
Chapter 1380

Student Loans

1380.10 Student loan scheme overview

The Student Loan Scheme Act 2011 (SLSA 2011) replaced the Student Loan Scheme Act 1992 with effect, generally, from 1 April 2012. The purposes of the SLSA 2011, which is administered primarily by Inland Revenue, are: the effective administration of student loans; the collection of student loan repayments; transparency about student loans so that borrowers understand their obligations; and the encouragement of borrowers to repay their student loans as soon as possible.

Student loan borrowers can access information about and manage their student loans via the internet. Most communications between Inland Revenue and borrowers are electronic, although more formal matters (such as objections) must be communicated in writing.

Loan managers and Inland Revenue are able to exchange information about borrowers, to enable Inland Revenue to provide borrowers with up-to-date information about their loan balances and to prevent fraud.

The way in which loan repayment obligations are met depends on the type of income of the borrower. Different repayment methods are used for salary and wages, pre-taxed income (eg, interest and dividends), and other income (eg, business or rental income).

For salary and wage earners, loan repayments are made by deduction from their salary or wages. A deduction is required only if income exceeds the repayment threshold (currently $19,084 per annum). Provided there is no significant over- or under-deduction, this deduction is the borrower’s final repayment obligation for the pay period. This means that there is usually no need for an annual assessment or square-up.

Borrowers with a secondary job can apply to transfer any unused repayment threshold from their main job to their secondary job. This option is not available to borrowers who are required to file an income tax return.

Full-year, full-time students who expect to earn less than the annual repayment threshold and are not required to file a return can apply to be exempt from having repayments deducted from their salary or wages.

Inland Revenue is not required to take any corrective action on under- or over-deductions from salary or wages unless they are significant. Borrowers can request a refund of any significant over-deduction. The CIR can collect significant under-deductions by additional deductions from future salary and wages, or by issuing an assessment.

Borrowers can ask their employer to make extra deductions (in addition to standard deductions) from their salary or wages, in order to reduce their loan balance or to pay unpaid amounts. Inland Revenue can require an employer to make extra deductions if there has been a significant under-deduction or to collect unpaid amounts.

Borrowers who intend to be overseas-based can defer their overseas-based repayment obligations for up to a year by applying in advance for a repayment holiday. The borrower must nominate a contact person living in New Zealand who is able to provide Inland Revenue with details of the borrower’s current address.
Note: the requirement to provide a contact person, and the provision of the borrower’s current address by that contact person, are measures introduced by the Student Loan Scheme Amendment Bill, which is currently before Parliament.

The CIR can also make a special assessment of the amount that ought to have been deducted from salary and wages, and require the borrower to pay the amount within 30 days. Special assessments can be used, for example, when a borrower has neglected to advise their employer that they are a student loan borrower.

Borrowers who derive pre-taxed income (ie, income that is not required to have student loan deductions made from it, such as interest, dividends and Maori authority distributions), and who are not required to file tax returns, must make an online declaration of the amount of their pre-taxed income. Certain deductions are permitted against pre-taxed income. The CIR then makes an assessment of the borrower’s repayment obligation in respect of net pre-taxed income. A pre-taxed income repayment obligation only applies to borrowers who earn $1,500 or more of pre-taxed income and whose combined income from salary or wages and net pre-taxed income exceeds the repayment threshold by $1,500 or more. The dates on which a borrower’s repayment obligations for pre-taxed income are due to be paid depend on the amount payable and whether the borrower estimated their obligation for the year. Borrowers with a pre-taxed income repayment obligation of $1,000 or more are required to make interim payments (similar to provisional tax) for the following tax year. Interim payments may be calculated using either the standard method (previous year’s obligation increased by five per cent) or the estimation method.

Borrowers who derive income other than salary or wages and pre-taxed income (such as business or rental income), and are therefore required to file a tax return, must meet their student loan repayment obligations along with their provisional tax obligations. Normally this will mean paying loan repayments along with their provisional tax, with an annual square-up covering all their income. The dates on which a borrower’s repayment obligations in respect of other income are due to be paid depend on the amount payable and whether the borrower estimated their obligation for the year. If the other income repayment obligation is less than $1,000, the amount is paid in one sum on the next provisional tax due date. If the other income repayment obligation is $1,000 or more, the amount must be paid on the same dates as the borrower’s provisional tax is due. If the borrower has used the estimation method or has an “other income” repayment obligation of $16,000 or more, the amount must be paid on the provisional tax due dates for that tax year. Borrowers with an “other income” repayment obligation of $1,000 or more are required to make interim payments (similar to provisional tax) for the following tax year. Interim payments may be calculated using either the standard method (previous year’s obligation increased by five per cent) or the estimation method.

Interest is only charged on loans to borrowers while they are based overseas. However, all borrowers are charged late payment interest on overdue payments at the rate of four per cent above the base interest rate (currently 6.6 per cent). This can be reduced by two per cent if the borrower enters into an instalment arrangement. Interest is not charged on unpaid amounts of less than $500.

Late payment penalties are imposed on borrowers who fail to provide, or who provide incomplete, declarations or notifications. Shortfall penalties apply where an incorrect tax position has been taken and the borrower is liable for a shortfall penalty for income tax. Shortfall penalties are imposed at the same rate as for taking an incorrect tax position. Penalties for criminal offences may also be imposed for wilfully or negligently failing to provide information to Inland Revenue.

Inland Revenue and the New Zealand Customs Service (Customs) can exchange certain information about borrowers to enable Inland Revenue to verify whether borrowers are New Zealand-based or overseas-based, and whether they are New Zealand residents. For these purposes, the CIR can provide Customs with a borrower’s name (or any alias), date of birth and tax file number. The CIR may access arrival and departure information held by Customs.

1380.20 New Zealand-based and overseas-based borrowers [SLSA 2011, ss 21 - 29]

Whether a borrower is New Zealand-based or overseas-based determines the type of repayment obligations that apply to them. In addition, overseas-based borrowers are liable to pay loan interest.
(1) New Zealand-based borrower
A borrower is New Zealand-based if the borrower is physically in New Zealand (or is treated as being
physically in New Zealand) for a period of 183 consecutive days. If a borrower leaves New Zealand during
this 183-day period they remain New Zealand-based provided they are not absent for more than 31 days in
total. The period of 183 days can begin before the person becomes a borrower.
If a borrower is physically in New Zealand for part of a day, they are treated as being physically in New
Zealand for the whole of that day.
A borrower is treated as being New Zealand-based from the later of the day they became a borrower and the
first day of the 183-day period.

(2) Overseas-based borrower
A borrower is overseas-based if they are not treated as being New Zealand-based. Therefore a New Zealand-
based borrower who is physically absent from New Zealand for a period of 184 consecutive days is overseas-
based. If a borrower comes back to New Zealand during the 184-day period they remain overseas-based
provided they are not physically present in New Zealand for more than 31 days in total. The period of 184 days
can begin before the person becomes a borrower.
A borrower is treated as being overseas-based from the later of the day they became a borrower and the first
day of the 184-day period.

(3) Borrowers treated as being physically in New Zealand
The CIR may, if the CIR considers it fair and reasonable to do so, treat the borrower as being physically in
New Zealand if the principal reason the person is not physically in New Zealand is because:
(a) The borrower is in the service of the New Zealand Government;
(b) The borrower is working as a volunteer or for token payment for a charity (see 1380.25);
(c) Of an unexpected delay;
(d) Of an unplanned personal absence;
(e) The borrower is required to be overseas because of their employment or occupation;
(f) The borrower is accompanying their spouse, civil union partner, or de facto partner overseas;
(g) The borrower is undertaking overseas study that meets the requirements of SLSA 2011 clauses 7,
8 or 9 of Schedule 1; or
(h) The borrower is in Niue, the Cook Islands, Tokelau or the Ross Dependency.
The specific conditions that must be met in order for a borrower to be treated as physically present in New
Zealand under each of paragraphs (b) to (h) above are set out in SLSA 2011 Schedule 1.

(4) Borrowers must notify CIR of absences exceeding 183 days
A borrower who intends to be absent from New Zealand for a period of 184 or more consecutive days must,
before leaving New Zealand, notify the Commissioner of the following:
(a) One of the following ways in which the CIR can notify the borrower:
   (i) A permanent overseas postal address;
   (ii) A New Zealand postal address; or
   (iii) The name and New Zealand postal address of a person empowered to act for the borrower;
(b) An electronic means of communication prescribed by the CIR (presumably an email address); and
(c) Any information the CIR needs to determine the borrower’s repayment obligation and liability to
    pay loan interest.
A borrower who left New Zealand without notifying the CIR must provide the same information as above,
as well as the date the borrower left New Zealand, as soon as practicable.
An overseas-based borrower who returns to New Zealand must, as soon as practicable, notify the CIR of the date they returned to New Zealand and any other information the CIR requires in order to establish whether the borrower is New Zealand-based.

1380.25 Charities for purposes of student loan scheme

From 1 April 2012, a borrower who is not physically in New Zealand may be treated by the CIR as physically in New Zealand if the main reason the borrower is overseas is because they are working as a volunteer or for token payment for a charity [1380.20]. The following organisations are classified as charities for this purpose [Student Loan Scheme (Charitable Organisations) Regulations 2011]:

- Adventist Development and Relief Agency International
- Amnesty International
- ANCOP Foundation International Inc
- Anglican Social Services (Hutt Valley) Trust Board
- Australian Volunteers International
- Aziza’s Place
- Bright Hope International Trust
- Caritas Internationalis
- CBM International
- ChildFund International
- Christian World Service (CWS)
- CORSO Incorporated
- Doctors Without Borders/Médecins Sans Frontières
- ECPAT International
- Engineers Without Borders New Zealand Incorporated
- Habitat for Humanity International
- Hare Krishna Food for Life Trust
- Hibiscus Coast East Timor Appeal Trust (HETA Trust)
- IHC New Zealand Incorporated
- IN Network
- International Care Ministries Limited
- International Federation of Red Cross and Red Crescent Societies
- International Save the Children Alliance
- Interserve (NZ)
- Livelihood International Foundation Trust
- Mahitahi Catholic Overseas Volunteer Trust
- Marist Mission Ranong
- Mission Aviation Fellowship of New Zealand Incorporated
- Mobility Equipment for the Needs of Disabled Trust
- National Spiritual Assembly of the Baha’is of New Zealand
- NET Ministries (National Evangelization Teams)
- New Zealand Church Missionary Society Trust Board
- New Zealand Family Planning Association Incorporated
New Zealand Vietnam Health Trust
OMF New Zealand
Oxfam International
Partners Relief and Development NZ
Pax Christi International
Pioneers
Presbyterian Church of Aotearoa New Zealand
RedR International
Restless Development
Richmond Fellowship International (RFI)
Rotary International
Servants to Asia’s Urban Poor Incorporated
SIM New Zealand
Soroptimist International
SurfAid International
Tandem Ministries
Te Ora Hou Aotearoa Incorporated
Te Tuao Tawahi: Volunteer Service Abroad Incorporated
TEAR Fund
The Cambodia Trust
The Church of Jesus Christ of Latter-Day Saints Trust Board
The Foundation for Peace Studies Aotearoa/New Zealand Incorporated
The Fred Hollows Foundation
The Leprosy Mission International (TLM)
The Salvation Army International
The UMMA Trust
The Volunteer Ophthalmic Services Overseas Trust
Trade Aid NZ Inc
United Nations Children’s Fund (UNICEF)
United Nations Development Fund for Women (UNIFEM)
Vietnam Cambodia and Laos Support Network (VICALSN)
Vision Pacific Charitable Trust
WEC International
World Vision International
World Young Women’s Christian Association (World YWCA)
WWF

Loan deductions from salary or wages [SLSA 2011, ss 33 - 49]
New Zealand-based borrowers who derive salary or wages normally have an “SL” student loan repayment code. A borrower who qualifies to have deductions made at a non-standard rate is allocated an “STC”
Student Loans

repayment code. The repayment code is combined with the employee tax code [see 1080.25]. A borrower must notify their employer of their repayment code, or if their repayment code changes.

An employer (or PAYE intermediary) is required to deduct loan repayments from each payment of salary or wages to a borrower. The amount deducted depends on whether the borrower has an “SL” or an “STC” repayment code.

“SL” repayment code: Deductions are made at the rate of 10 per cent of each complete dollar of primary employment earnings in excess of the pay period repayment threshold. Deductions are made at the rate of 10 per cent from any secondary employment earnings paid to the borrower.

Example:
A borrower’s fortnightly gross salary is $1,154. The annual repayment threshold is currently $19,084. The pay period repayment threshold is $734 ($19,084 ÷ 26). The employer is therefore required to make a deduction of $42 [(($1,154 – $734) × 10%). In practice, the employer does not have to calculate the amount of the deduction because the amounts are built into the PAYE tables published by Inland Revenue.

Borrowers with secondary jobs can apply to transfer any unused repayment threshold from their main job to their secondary jobs.

“STC” repayment code: Deductions are made from all primary and secondary employment earnings at the rate specified in the special deduction rate certificate.

In addition to the standard deductions, employers must also make additional deductions if instructed to do so by Inland Revenue or requested to do so by the borrower. Inland Revenue can require an employer to make extra deductions, at a rate not exceeding 5 per cent, if there has been a significant under-deduction, or to collect unpaid amounts. Borrowers can ask their employer to make extra deductions (over and above the standard deductions) from their salary or wages in order to reduce their loan balance or to pay unpaid amounts.

1380.40 Over- and under-deductions [SLSA 2011, ss 63 - 68]

If deductions are not made from a borrower’s salary or wages, or if the incorrect amount is deducted, Inland Revenue is not required to take any corrective action unless the error is significant. Borrowers can request a refund of any significant over-deduction, and the CIR can collect significant under-deductions from future salary and wages (or issue an assessment if deduction is not possible).

The CIR is authorised to decide what the thresholds for significant under- and over-deductions are, taking into account the need to maintain the integrity of the student loan scheme and having regard to the resources available to the CIR.

A borrower who believes that a significant over-deduction has been made from their salary or wages can apply for a refund within 6 months after the date the deduction was made. Once the CIR confirms that a significant over-deduction has been made, the borrower then has 6 months from the date of the CIR’s confirmation to ask the CIR for a refund. The CIR can offset a significant over-deduction against any significant under-deduction identified in the same tax year, before any refund is made.

Note: the CIR’s ability to offset an over-deduction against any under-deduction, is an amendment introduced by the Student Loan Scheme Amendment Bill, which is currently before Parliament. This measure is expected to take effect from 1 April 2012.

If there has been a significant under-deduction, the CIR can recover the under-deduction by requiring that additional deductions be made from the borrower’s salary or wages, or by issuing a special assessment of the amount that ought to have been deducted. The amount due under a special assessment is payable within 30 days.

1380.50 Exemption for full-time students [SLSA 2011, ss 53 - 60]

Full-time students can apply to be exempted from standard deductions if they reasonably expect that the annual repayment threshold will not be exceeded by the total of their:

(a) Gross income from salary or wages;
(b) Net pre-taxed income (if any); and
To obtain the exemption, the student must make a declaration to the CIR specifying the applicable tax year, exemption period and any other prescribed information.

A “full-time student” is a borrower who is undertaking (or will undertake) a programme of study that:

(a) Is 32 weeks or longer in duration in any 52-week period and at least 0.8 of equivalent full-time student units [per Education Act 1989 s 159]; or
(b) Is 12 weeks or longer in duration in any 52-week period and at least 0.3 of equivalent full-time student units or the equivalent on a pro rata basis.

The exemption is likely to apply in the situation where a student has a part-time or holiday job and is earning more than the pay period repayment threshold for the periods they are working, but will earn less than the annual repayment threshold for the year as a whole.

1380.60 Loan interest [SLSA 2011, ss 133-143]

The default position is that interest is payable on the loan balances of all borrowers. However, no interest is payable on any day that a borrower is New Zealand-based.

Interest is calculated on a daily basis on the loan balance, and is charged and added to a borrower’s loan balance at the end of each year. After the interest has been added to the borrower’s loan balance, the CIR must notify the borrower in writing that interest has been added to the loan balance, of the new total of that balance, and that the new loan balance is subject to interest.

Interest is calculated at the base interest rate, which is currently 6.6 per cent.

An overseas-based borrower who returns to New Zealand, who would qualify as a New Zealand based-borrower, and who pays off their consolidated loan balance within 183 days of returning to New Zealand is not charged interest from the day they arrive back in New Zealand.

1) Late payment interest

Late payment interest is charged on any unpaid amount of $334 or more ($500 or more from 1 April 2013). An “unpaid amount” means any of the following, together with any late payment interest that has been added to it:

(a) A remaining repayment;
(b) An interim payment default;
(c) An overseas-based instalment default;
(d) A consolidated loan balance that is payable as a result of a demand made under a loan contract;
(e) Any part of a loan advance or a loan balance that the CIR has recalled or demanded payment of under SLSA 2011 s 204.

Late payment interest is calculated, charged and added to a borrower’s unpaid amount as follows:

(a) 0.843 per cent of the unpaid amount on the day after its due date; and
(b) 0.843 per cent of the unpaid amount as at each day that falls 1 month after the day on which late payment interest is imposed under paragraph (a).

From 1 April 2013, interest will be charged at the base interest rate plus 4 percent (ie, 10.6 per cent in total).

If a borrower enters into, and meets their obligations under, an instalment arrangement, monthly interest charged under (b) is written off during the period of the arrangement. From 1 April 2013, interest is not written off, but monthly interest is reduced to the base interest rate plus two per cent.

1380.70 Repayment holiday for overseas-based borrowers [SLSA 2011, ss 105-108A]

The effect of a repayment holiday is that the borrower has no overseas-based repayment obligation for the period of the holiday. A borrower who intends to be overseas-based can apply to the CIR for a repayment holiday.
holiday. The application can be made either from New Zealand or from overseas, but a person who is already an overseas-based borrower cannot apply for a repayment holiday. This means that a borrower who leaves New Zealand must apply for a repayment holiday within 183 days of the date of departure.

Note: the Student Loan Scheme Amendment Bill, which is currently before Parliament, contains an amendment requiring a borrower to apply to the CIR for a repayment holiday. This measure is expected to take effect from 1 April 2012. Currently, borrowers are automatically entitled to a repayment holiday.

The Student Loan Scheme Amendment Bill also contains a requirement for the borrower applying for a repayment holiday to provide a contact person. These measures are expected to take effect from 1 April 2012. The following commentary is based on the new provisions as contained in the Bill.

In applying for a repayment holiday the borrower must nominate an individual who resides in New Zealand as a contact person. The individual must be willing to act as the contact person, and the following information about the individual must be provided to the CIR:

(a) Name;
(b) A New Zealand postal address;
(c) An electronic address (if they have one); and
(d) A New Zealand telephone number (if they have one).

A borrower who is granted a repayment holiday becomes entitled to that holiday on the day the borrower becomes overseas-based.

The Student Loan Scheme Amendment Bill amends the repayment holiday provisions significantly. Currently, the maximum period for which a borrower can have a repayment holiday is three years. The following commentary is based on the new provisions as contained in the Bill, which are expected to take effect from 1 April 2012.

(1) Period of repayment holiday

Under the Student Loan Scheme Amendment Bill, the maximum period for which a borrower can have a repayment holiday is 365 days. This could be either one continuous period of 365 days or several periods which together total 365 days. A borrower who has had one or more repayment holidays under the Student Loan Scheme Act 1992 totalling three years is unable to have further repayment holidays.

If a borrower has taken repayment holidays totalling less than three years under the SLSA 1992, the borrower is able to take repayment holidays for a period or periods totalling the lesser of:

(a) 365 days; and
(b) The remainder of the days the borrower would have been entitled to under the Student Loan Scheme Act 1992.

Example:
Richard took a repayment holiday in 2009 and 2010 (under the SLSA 1992) for a total of 550 days. He plans to work in the USA for two years starting June 2012, and applies for a repayment holiday. The remainder of the days that would have been available under the SLSA 1992 is 545, calculated as $3 \times 365 - 550$. The maximum period the CIR can approve as a repayment holiday under the SLSA 2011 is 365 days, the lesser of 365 and 545.
Chapter 1390
Superannuation

1390.10 Superannuation funds and superannuation schemes

“Superannuation fund” means any superannuation scheme registered under the Superannuation Schemes Act 1989, or a KiwiSaver scheme that is registered under the KiwiSaver Act 2006. Where the fund is a trust, it means the trustees of the fund.

“Superannuation scheme” means:
(a) Any trust or unit trust established by its trust deed principally to provide retirement benefits to natural persons or paying benefits to superannuation funds;
(b) A non-resident company (other than a unit trust) established principally to provide retirement benefits to members or their relatives who are natural persons; or
(c) Statutory arrangements under an Act in New Zealand (other than the Social Security Act 1964) or similarly constituted under legislation outside New Zealand to provide retirement benefits to natural persons.

In item (c) above, a specific exclusion is provided for arrangements under the Social Security Act. Therefore, New Zealand Superannuation, to which every New Zealander gains entitlement by the age of 65, is neither a superannuation fund nor a superannuation scheme for the purposes of the discussion that follows.

“Superannuation contribution” means any disposition of property to or for the benefit of a superannuation scheme to the extent to which fully adequate consideration does not pass from the superannuation scheme to any person, other than as a benefit under the terms of the scheme.

1390.15 Taxation of superannuation funds

The following rules apply to the taxation of superannuation funds.

(1) Fund income

The income of the superannuation scheme includes profits and losses from the sale of investments. This principle has been established through a line of cases relating to banks and other financial institutions beginning with Californian Copper Syndicate v Harris (1904) 5 TC 159.

Personal contributions of members are not included in income and no deduction is allowable for any benefit paid out of the scheme, or any expenditure which is recoverable from a contributor.
Superannuation

Where a superannuation fund invests in a policy of life insurance offered or entered into in New Zealand, any amount that the fund derives from the policy is excluded income [s CX 40].

(2) Fund deductions

Under s DV 1, a superannuation fund is allowed a deduction for developing, marketing, selling, promoting, and advertising for members. This deduction does not apply to expenditure in respect of the following items:

(a) Expenditure incurred in acquiring plant, machinery, equipment, land, or buildings.
(b) Expenditure which is not income of the recipient.

The provision specifically supplements the general permission and over-rides both the capital limitation and the exempt income limitation.

While a superannuation fund (“member fund”) has funds invested in another superannuation fund (“master fund”) the member fund may incur expenditure in developing, marketing, selling, promoting, or advertising for members or in managing the fund. Where this occurs, the member fund is able to choose to treat some or all of the expenditure as being incurred by the master fund in deriving its assessable income. This treatment does not apply to expenditure in respect of the following items:

(a) Expenditure incurred in acquiring plant, machinery, equipment, land, or buildings;
(b) Expenditure which is not income of the recipient.

To avail itself of this concession, the member fund must make an election by giving notice to the CIR by the due date for filing its return of income or such further time as the CIR may allow [s DV 2].

The maximum amount that the member fund can elect be treated as expenditure incurred by the master fund is set down in s DV 3 as being:

\[
\text{taxable income} - \text{non-resident passive income}
\]

Where:

“Taxable income” is the taxable income of the master fund (before the impact of these provisions) for the tax year in which the expenditure is incurred.

“Non-resident passive income” is the total of non-resident passive income of the kinds to which s RF 2(5) applies (where the NRWT is a minimum tax), derived by the master fund for the tax year in which the expenditure was incurred.

The expenditure so allowed as a deduction to the master fund is then deemed not to be incurred by the member fund.

If the master fund has insufficient qualifying income with which to absorb the expenditure that the member fund wishes to transfer, the member fund has two options with regard to the excess. These are to:

(a) Deduct the excess expenditure against its own income; or
(b) Carry the excess expenditure forward to offset against master fund income in the following income year.

The second option is available only for so long as the member fund continues to have funds invested in the master fund.

Where the second option is chosen, the expenditure is deducted from the income of the master fund in the order in which the expenditure was incurred.

(3) Fund status

Resident settlers of a superannuation fund are not liable for income tax. It is the trustee who is liable [s HC 29(4)].

A superannuation fund is deemed to be a trust that can derive only trustee income and is taxed at the trustee income rates. The income derived by a trustee of a superannuation fund is not beneficiary income [s HC 6].
(4) **Distributions and benefits**

As a superannuation fund is a complying trust and cannot have distributions assessed as beneficiary income, it follows that all payments to beneficiaries from the superannuation fund must be either from trustee income or capital, and thus tax free to the payee.

If a superannuation fund provides a member with a loan that would be a fringe benefit if provided by an employer to an employee, the “value” of the loan is deemed to be income derived by the fund in that income year [s CS 18].

Superannuation funds that meet certain criteria are able to elect to become portfolio investment entities (PIEs) [see 1130 PORTFOLIO INVESTMENT ENTITIES].

### 1390.20 Foreign superannuation schemes

The taxation of foreign superannuation schemes may fall into the taxation of trusts regime or the taxation of foreign investment funds regime. Even though a foreign superannuation scheme is not a superannuation fund (and hence is not a qualifying trust), this does not exclude it from the trust regime. In the taxation treatment of interests in trusts, other than trusts which constitute superannuation funds, it is necessary to distinguish between trusts for which the beneficiary is a subscriber, purchaser, or contributor (contributory schemes) and other trusts (non-contributory).

The tax treatment of income derived by the trustees of trusts other than superannuation funds and of the distributions made may be summarised as follows:

(a) With non-contributory schemes, the income is taxed according to the trusts regime.

(b) With contributory schemes, the income is taxed, depending upon its inherent features, either:

   (i) As if the scheme is a foreign investment fund; or

   (ii) If it is resident, or if non-resident but not being a foreign investment fund, it is taxed as if it is a company, with the distributions being treated as dividends.

Under the Income Tax (Alternative Arrangement for Overseas Pensions) Commencement Order 1996 (SR 1996/346), as from 1 April 1997 New Zealand residents who receive a UK social security pension may have the pension paid to a special bank account drawn on by Work and Income New Zealand. The pensioner may then receive a full New Zealand superannuation or veteran’s pension.

### 1390.25 Costs of altering trust deed are deductible

The costs of creating or altering a superannuation scheme are deductible for tax purposes. This is because a superannuation fund is mainly for the benefit of employees and, as such, is part of the wage structure mechanism. Superannuation is a method of keeping good staff who assist in the production of the employer’s income. Therefore, the costs of establishing a superannuation fund are not of the same nature as the formation expenses of a company or business, and so a deduction is not denied by the capital prohibition.

### 1390.30 When employer contributions deductible [ss DC 7, EJ 21]

An employer is permitted a deduction for a superannuation contribution to an employee’s superannuation scheme.

The employer is able to choose to allocate the deduction to either:

(a) The income year for which the deduction was required by the superannuation scheme to be made; or

(b) The income year for which the amount of the contribution was calculated based on the earnings of the members of the scheme, provided that the payment is made within 63 days following the end of the income year.

### 1390.35 Taxation of contributions [ss BE 1, CX 49, CX 50B]

An employer’s superannuation cash contribution is excluded income of both the employee for whose benefit the contribution is made and the superannuation scheme to whom the contribution is made [s CX 49]. Contributions to a retirement savings scheme are excluded income of the scheme.
Contributions to a retirement savings scheme are also excluded income of the person for whose benefit the contribution is made. However, the following conditions apply:

(a) The excluded income treatment applies only to the extent to which the contribution is money or an amount of imputation credit or Maori authority credit that is used to meet the liability of the contributor for retirement scheme contribution withholding tax on the contribution;

(b) The excluded income treatment does not apply if:
   (i) The person for whose benefit the contribution is provided supplies a withholding rate that is lower than it should be;
   (ii) The person includes the contribution in a return of income for the income year in which the contribution is made; or
   (iii) The person is a non-resident and the contribution is non-resident withholding income.

**TaxNote:** Employer contributions to schemes can be subject to fringe benefit tax (FBT) or to employer’s superannuation contribution tax (ESCT) or to retirement scheme contribution tax (RSCT).

### 1390.40 When employer contributions subject to fringe benefit tax

Fringe benefit tax (FBT) applies to any contribution to a superannuation scheme which is not an “employer’s superannuation cash contribution”. An “employer’s superannuation cash contribution” [as defined in s YA 1] means an employer superannuation contribution made in money, to a superannuation fund, for the benefit of one or more employees This means that non-monetary contributions to a superannuation fund (such as vesting buildings, plant, or other assets) are subject to FBT.

As FBT applies to any superannuation contribution which is not a specified superannuation contribution, it also follows that it applies to monetary contributions to funds which are overseas constituted and classified by the Government Actuary under regs 29 and 30 of the Superannuation Schemes Regulations 1983, and to monetary contributions to other funds which are not in superannuation category 1 or 2 (ie superannuation category 3 funds and other funds).

For further details see 540 FRINGE BENEFIT TAX.

### 1390.45 Employer contributions and employer’s superannuation contribution tax [ss RD 67, RD 68, RD 69]

Superannuation contributions can be subject to:

(a) Fringe benefit tax (FBT);

(b) PAYE, where the employee has elected under s RD 68 that the contribution be treated as salary and wages and PAYE apply and that election has not been revoked in writing [see TES 7 (August 2003) 96]; or

(c) Employer’s superannuation contribution tax (ESCT).

ESCT (styled as withholding tax), applies to monetary contributions made by an employer as a superannuation contribution to a superannuation fund [ss RD 64 to RD 71].

The tax is a final tax and no employer’s superannuation cash contribution is included in income for the fund. The tax rate is dependent on the income level of the employee. The range of rates and the income thresholds to which they apply are set out in sch 1, Part D, Table 1. The threshold bands relate to the total salary and wages plus employer superannuation contributions paid to the employee in the previous year. From 1 October 2010, the rates are:

<table>
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<tr>
<th>Threshold Amount</th>
<th>Tax Rate</th>
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<tbody>
<tr>
<td>$0 - $16,800</td>
<td>10.50%</td>
</tr>
<tr>
<td>$16,801 - $57,600</td>
<td>17.50%</td>
</tr>
<tr>
<td>$57,601 - $84,000</td>
<td>30%</td>
</tr>
</tbody>
</table>
Over $84,000 33%

**TaxNote:** Where the employee was employed for the whole of the immediately preceding income year, the rates are applied to the amount of salary or wages derived by the employee in that preceding income year. Where the employee was not employed for the whole of the immediately preceding income year, the rates are applied to an amount that the employer estimates the employee will derive in the current income year. Where the contribution is being made to a defined benefit fund, the employer also has the option of using a flat rate of 33 per cent.

The expenditure is deductible in the year that the specified superannuation contributions are made [s EF 2].

**1390.50 Retirement savings scheme contributions** [ss RH 3, RH 4, RH 5, RH 6, CX 50B; TAA, ss 28C, 47B, 48, 48B]

Superannuation contributions can be subject to:

(a) Fringe benefit tax (FBT);
(b) PAYE, where the employee has elected under s RD 68 that the contribution be treated as salary and wages and PAYE apply;
(c) Employer’s superannuation contribution tax (ESCT); or
(d) Retirement scheme contribution tax (RSCT).

(1) **Retirement savings schemes**

An entity is eligible to be a retirement savings scheme where the CIR has approved the distribution rules as being fair and following conditions are met:

(a) The entity is a portfolio investment entity;
(b) The entity holds funds from a retirement scheme contribution for the person;
(c) Distributions to members of the scheme cannot be made before the person reaches a retirement age which is stipulated in the scheme’s rules; and
(d) Distributions to members before the stipulated retirement age are limited to withdrawals for the following reasons:
   (i) Repayment of a student loan;
   (ii) Payment of fees and expenses relating to tertiary education;
   (iii) The purchase of a home (if the person does not already own a home);
   (iv) A reason allowed under the KiwiSaver Act 2006; or
   (v) Other reasons specified in the rules and approved by the CIR.

(2) **Retirement scheme contributors**

An entity is eligible to be a contributor for a person if:

(a) The entity is the trustee of a widely held unit trust, a company (other than a close company), or a Maori Authority; and
(b) The person is a unit holder, shareholder, or member, of the entity.

(3) **Retirement scheme contribution tax**

RSCT (styled as withholding tax) applies to monetary contributions made by contributor on behalf of a member of the scheme. RSCT is a final tax and no retirement scheme contribution is included in income for the fund. The tax is at the rate for the person on whose behalf the contribution is being made, depending on the person’s income in the previous two income years. The rates and the circumstances under which they apply are set out in sch 1, Part D, Table 5 of the ITA 2007.

For the 2010-2011 and later income years, up to and including 30 September 2010, the rates are:
Payee’s tax file number supplied, and payee elects to apply this rate 12.5%
Payee is a non-resident, contributor is a Maori authority and the distribution is $200 or less 12.5%
Payee’s tax file number supplied and notification given that 21 per cent is not less than the person’s retirement scheme prescribed rate 21%
Payee’s tax file number supplied, and notification has been given that 33 per cent is not less than the person’s retirement scheme prescribed rate 33%
In all other cases 38%

From 1 October 2010, the rates are
Payee’s tax file number supplied, and payee elects to apply this rate 10.5%
Payee is a non-resident, contributor is a Maori authority and the distribution is $200 or less 10.5%
Payee’s tax file number supplied and notification given that 21 per cent is not less than the person’s retirement scheme prescribed rate 17.5%
Payee’s tax file number supplied, and notification has been given that 33 per cent is not less than the person’s retirement scheme prescribed rate 30%
In all other cases 33%

The contributor is required to deduct the RSCT from the amount of the contribution. The amount of the contributions includes amounts in the form of money, imputation credits and Maori authority credits. The amount deducted is required to be paid to the CIR no later than the 20th of the month following the month in which the deduction was made. The contributor can appoint the retirement scheme as agent in respect of these obligations.

Failure to make and remit deductions of RSCT result in a debt to the CIR with the normal penalties and collection procedures applying.

The contributor is also required to file a reconciliation statement for the income year. The statement is required to be filed before the end of the second month following the end of the income year. In respect of each person for whom a retirement scheme contribution has been made, all of the following information is required to be included in the statement:

(a) The total amount of RSCT payable on retirement scheme contributions;
(b) The total amount of imputation credits and Maori authority credits used in meeting the liability for RSCWT;
(c) The total amount of RSCT paid or payable other than by using imputation credits and Maori authority credits;
(d) The amount of each retirement scheme contribution subject to RSCWT;
(e) The rate used to calculate the RSCT on the retirement scheme contribution;
(f) The RSCT for the retirement scheme contribution;
(g) The amount of imputation credits attached to the retirement scheme contribution;
(h) The amount of imputation credits used to meet the liability for RSCT on the retirement scheme contribution;
(i) The amount of Maori authority credits attached to the retirement scheme contribution;
(j) The amount of Maori authority credits used to meet the liability for RSCT on the retirement scheme contribution;
(k) The amount of RSCT remaining owing on the retirement scheme contribution after the use of imputation credits and Maori authority credits;
The amount of RSCT on the retirement scheme contribution paid other than by the use of imputation credits and Maori authority credits;

The tax file number, if a rate of less than is 38 per cent (33 per cent from 1 October 2010) is used to calculate the RSCT on a retirement scheme contribution;

The amount of the imputation credits or Maori authority credits attached to the retirement scheme contribution that are not used to meet the liability for RSCWT;

The total amount of non-resident withholding tax payable on retirement scheme contributions;

The amount of each retirement scheme contribution that is non-resident passive income; and

Any other particulars the CIR may require.

In addition, all of the following information must be supplied in the reconciliation statement in relation to the contributor:

The total amount of retirement scheme contributions for which RSCT is payable;

The total amount of RSCT payable on retirement scheme contributions;

The total amount of imputation credits used in meeting the liability for RSCWT;

The total amount of Maori authority credits used in meeting the liability for RSCWT; and

The total amount of RSCT paid or payable other than by using imputation credits and Maori authority credits.

Treatment in the hands of the scheme member

Contributions are excluded income of the retirement savings scheme. Contributions do not affect entitlements to social assistance. It is also excluded income of the person on whose behalf it is made. However, it is not excluded income where any of the following applies:

The person is a non-resident and the contribution is non-resident passive income

The person supplies to the contributor a tax rate that is lower than it should be; or

The person includes the amount in a return of income for the income year in which the contribution is made.

When employer receives a benefit from a superannuation scheme [s CG 5]

If the employer has received any benefit in money or money’s worth, including the recovery of contributions, from a superannuation scheme to which employer superannuation contributions have been made at any time, the amount recovered or received is treated as income of the employer.

The income is allocated to the income year in which the amount is recovered or received.

When pensions are deductible [s DC 2]

Instead of providing for an employee’s retirement through a superannuation fund, an employer may wish to keep the employee on the payroll. A deduction for pensions paid to former employees or their dependants is allowed in the following circumstances.

Not a close company

A deduction is allowed for a reasonable amount paid as a pension to the former employee where all of the following apply:

The person is not a close company;

The person carries on a business;

The employee’s employment has ended through retirement, redundancy or other similar circumstance;

The employer pays to the employee a pension in consideration of past services in the business; and
(e) The employee (or employee’s spouse [see 960.10]) has a right to receive the pension for a fixed period of time or for life or, in the case of the spouse, has entered a new marriage, civil union or de facto relationship.

The deduction is allocated to the income year in which the amount is paid.

(2) **Close company**

A deduction is allowed for the amount that the company would have paid as a pension had the former employee or relative not been a shareholder in the company where all of the following apply:

(a) The close company carries on a business;

(b) A former employee is a current or past shareholder of the company or is a relative of a current or past shareholder;

(c) The former employee’s employment was genuine;

(d) The employee’s employment has ended through retirement, redundancy or other similar circumstance;

(e) The employer pays to the employee a pension in consideration of past services in the business; and

(f) The employee (or employee’s spouse) has a right to receive the pension for a fixed period of time or for life or, in the case of the spouse, has entered a new marriage, civil union or de facto relationship.

The deduction is allocated to the income year in which the amount is paid.

See *Simpson v Commissioner of Inland Revenue* (1982) 5 NZTC 61,231 (HC) for a discussion on ceasing employment.
### Chapter 1395

**Tax Credits**

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### 1395.10 Tax credits in general [ss BC 8, LA 1, LA 2, LA 3, LA 4, LA 5, LA 9]

A tax credit is an amount that:

(a) Reduces a taxpayer’s income tax liability (eg credits for PAYE, RWT or provisional tax);

(b) Is paid to a person in cash (eg housekeeper, charitable donations, WFF, or redundancy payment tax credits); or

(c) Is otherwise used or applied for the person’s benefit (eg KiwiSaver member tax credits).

The housekeeper [s LC 6] and charitable donations [s LD 1] tax credits are refunded to the taxpayer in full under s 41A of the TAA. The total of all other tax credits for a tax year under Part L are required to be used to satisfy the person’s income tax liability for that tax year [s LA 2]. An amount of tax credit may be used only once [s LA 9, see 1395.90].

1. **Income tax liability exceeds total tax credit [ss BC 8, LA 3]**

If the total tax credit is less than the income tax liability the difference, known as terminal tax [see 1150.70], must be paid to satisfy the person’s income tax liability for the tax year.

2. **Total tax credit exceeds income tax liability [ss BC 8, LA 4, LA 5]**

If the total tax credit is more than the income tax liability, the way in which the excess tax credits are used depends on the type of credit. Tax credits must be used to satisfy a person’s income tax liability in the following order:

(a) First, non-refundable tax credits [see 1395.20];

(b) Secondly, tax credits for supplementary dividends;

(c) Thirdly, tax credits for imputation credits; and

(d) Fourthly, refundable tax credits [see 1395.20].

Any remaining tax credits are dealt with as follows:

(a) Non-refundable credits are extinguished (lost);
(b) Credits for supplementary dividends may be used by applying s LP 3, which allows the credits to be transferred to another company in the same wholly-owned group or carried back to any one of the four preceding tax years. Any credits still remaining after this must be carried forward;

(c) Imputation credits are used by applying ss LE 2, LE 2B or LE 3. In the case of companies and trustees, remaining imputation credits are converted to a tax loss, which may then be carried forward. In the case of individuals, the remaining tax credit is carried forward; and

(d) Any remaining refundable tax credits are applied by the CIR [see 1395.15].

1395.15 Treatment of remaining refundable credits [ss LA 6, LA 7, LA 8]

If the remaining refundable credits for a tax year consist of tax credits for PAYE, provisional tax, RWT, RSCT, FDP, research and development expenditure, Maori authority credits, or tax credits for portfolio tax rate entities and investors (tax credits for multi-rate PIEs, from the 2010-2011 income year) the CIR must apply the credits in the following way (in this order):

(a) To satisfy the person’s income tax liability for an earlier tax year;

(b) To satisfy the person’s income tax liability for a later tax year, starting with the earliest year;

(c) To pay the person’s provisional tax for a later tax year, starting with the earliest year;

(d) If the credit is a research and development tax credit, to pay an amount that is payable by the person under an Inland Revenue Act [s LH 2(6)];

(e) To treat the tax credit as tax paid in excess and transferable under Part 10B of the TAA [see 1215.30 to 1215.48]; and

(f) Refund the tax credit as set out in ss RB 4, RM 2 to RM 8, and RM 10 and the TAA [see 1215.10].

If the remaining refundable credit for a tax year is:

(a) An abating WFF tax credit or a minimum family tax credit (under s LB 4), or

(b) A tax credit for charitable and other public benefit gifts (under s LD 1),

the CIR must treat the credit as transferable under Part 10B of the TAA, or refundable under ss RB 4, RM 2 to RM 8, and RM 10 (as applicable) [see 420.65].

If the remaining refundable credit for a tax year is a tax credit for NRWT, the CIR must:

(a) First, treat the tax credit as tax paid in excess and transferable under Part 10B of the TAA; and

(b) Secondly, refund the tax credit as set out in ss RB 4, RM 2 to RM 8, and RM 10 (as applicable) [see 1020.75].

1395.20 Refundable and non-refundable tax credits — definition [s YA 1]

“Non-refundable tax credits” are defined as:

(a) Tax credits for natural persons) [subpart LC], excluding the housekeeping tax credit [s LC 6];

(b) Tax credits for payroll donations [s LD 4];

(c) Tax credits for foreign income tax [subpart LJ];

(d) Tax credits relating to attributed CFC income [subpart LK];

(e) Tax credits of CTR companies [subpart LQ];

(f) Tax credits for policyholder income [subpart LR];

(g) An amount in a person’s BETA or PCA that the person chooses under Part O to credit in payment of tax; or

(h) Tax credits to investors who are allocated credits under subpart LJ, received by a portfolio tax rate entity or a portfolio investor proxy [s HL 29(7)(a)].

“Refundable tax credits” are defined as:

(a) Tax credits for payments, deductions and families [subpart LB];
(b) Tax credits for FDP credits [subpart LF], excluding credits for persons who are non-resident or who receive exempt income [s LF 8];
(c) Tax credits for research and development expenditure [subpart LH];
(d) Tax credits for Maori authorities [subpart LO];
(e) Tax credits relating to multi-rate PIEs and their investors [ss LS 2, LS 3(2) and LS 4(2)];
(f) Tax credits for multi-rate PIEs to the extent to which they arise under ss HM 53 or HM 55 (which relate to the use of tax credits other than foreign tax credits) [s LS 1].

1395.30 Schedule of tax credits

The following table is a complete list of tax credits available under the ITA 2007.

<table>
<thead>
<tr>
<th>Description of tax credit</th>
<th>Section</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>PAYE</td>
<td>LB 1</td>
<td>1395.40, 1215.20</td>
</tr>
<tr>
<td>Provisional tax</td>
<td>LB 2</td>
<td>1395.40, 1150.70</td>
</tr>
<tr>
<td>Resident withholding tax (RWT)</td>
<td>LB 3</td>
<td>1395.40</td>
</tr>
<tr>
<td>Abating WFF tax credit</td>
<td>LB 4,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>MB, MC, MD, MF</td>
<td>420.20</td>
</tr>
<tr>
<td>Minimum family tax credit</td>
<td>LB 4,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>MB, MC, ME, MF</td>
<td>420.50</td>
</tr>
<tr>
<td>Non-resident withholding tax (NRWT)</td>
<td>LB 5</td>
<td>1395.40, 1020.75</td>
</tr>
<tr>
<td>Retirement scheme contribution tax (RSCT)</td>
<td>LB 6</td>
<td>1395.40</td>
</tr>
<tr>
<td>Personal rehabilitation payments (providers)</td>
<td>LB 7</td>
<td>20.75, 1395.40</td>
</tr>
<tr>
<td>Personal rehabilitation payments (payers)</td>
<td>LB 8</td>
<td>20.75, 1395.40</td>
</tr>
<tr>
<td>School child tax credit</td>
<td>LC 3</td>
<td>1395.55</td>
</tr>
<tr>
<td>Transitional tax credit</td>
<td>LC 4</td>
<td>1395.60</td>
</tr>
<tr>
<td>Housekeeper</td>
<td>LC 6</td>
<td>1395.65</td>
</tr>
<tr>
<td>Absentees</td>
<td>LC 9</td>
<td>1000.35</td>
</tr>
<tr>
<td>Independent earner tax credit</td>
<td>LC 13</td>
<td>1395.70</td>
</tr>
<tr>
<td>Charitable donations</td>
<td>subpart LD</td>
<td>1395.75</td>
</tr>
<tr>
<td>Imputation credit</td>
<td>subpart LE</td>
<td>670.50, 670.55</td>
</tr>
<tr>
<td>Foreign dividend payment (FDP) credit</td>
<td>subpart LF</td>
<td>670.185</td>
</tr>
</tbody>
</table>
A tax credit that a person has under Part M is excluded income of the person [s MA 3].

(1) **Terminating provisions**

Subpart LZ sets out terminating provisions relating to various tax credits including the UFTC and credits for certain non-resident investment companies, home vendor mortgages, and special home ownership accounts. Subpart MZ sets out terminating provisions relating to the child tax credit.

**1395.40 Credits for tax paid or deducted** [ss LB 1, LB 2, LB 3, LB 4, LB 5, LB 6, LB 7, LB 8]

Tax that a person has paid and tax deducted from income paid to a person, during the tax year are tax credits that may be used to satisfy the person’s income tax liability for that tax year. The following payments or deductions give rise to tax credits.

(1) **Tax credits for PAYE income payments** [s LB 1]

A person has a tax credit for a tax year equal to the total amount of tax shown as withheld from PAYE income payments paid to the person in the employer monthly schedules provided by the person’s employer to the CIR.

If the employer is a close company, the amount of the tax credit must not exceed the amount of tax paid to the CIR if:

(a) The employer and the employee are associated persons, or the employer and the spouse of the employee are associated persons; and

(b) The employer withheld the amount of tax for the PAYE income payment shown in the employer monthly schedule.
The person’s credit is extinguished if the CIR does not receive an employer monthly schedule for the relevant amount of tax, or if the relevant particulars of the schedule are incorrect. The credit is restored if the error is corrected.

(2) **Tax credits for provisional tax payments [s LB 2]**

A person has a tax credit for a tax year equal to the amount of provisional tax for the tax year paid by the person or their agent (if the agent is liable to pay provisional tax on the person’s behalf).

(3) **Tax credits for resident withholding tax [s LB 3]**

A person has a tax credit for a tax year equal to the amount of tax withheld and paid in relation to their resident passive income for the tax year. The evidential requirements of s 78D of the TAA must be met (including a RWT withholding certificate).

The amount of tax credit for a multi-rate PIE and an investor in a multi-rate PIE is limited to the extent allowed under subpart HM) [see 1130 PORTFOLIO INVESTMENT ENTITIES].

(4) **Tax credits for families [s LB 4]**

A person has a tax credit for a tax year equal to the total amount of their abating WFF tax credit (subpart MD) and minimum family tax credit (subpart ME) for the tax year. [See 420.20 and 420.50.]

A person’s tax credit is adjusted if an instalment of the credit (under subpart MF) is used to satisfy an amount of tax for an earlier income year. The adjustment is equal to the total amount of instalments payable under s MF 1 that are recovered by the CIR under s MF 6 as tax payable by the person [see 420.70].

(5) **Tax credits for non-resident withholding tax [s LB 5]**

A person has a tax credit for a tax year equal to the amount of tax withheld and paid in relation to their non-resident passive income [see 1020.75].

(6) **Tax credits for RSCT [s LB 6]**

If the person is resident in New Zealand, they have a tax credit for a tax year equal to the RSCT withheld if:

(a) The person derives income as a retirement scheme contribution;
(b) The retirement scheme contributor pays RSCT for the contribution; and
(c) The income is not excluded income under s CX 50B [see 1390.98, 1390.107].

If the person is not resident in New Zealand, they have a tax credit for the tax year of an amount equal to the excess of RSCT withheld over NRWT paid in relation to the contribution.

If the person is not resident in New Zealand and the retirement scheme contribution is a taxable Maori authority distribution, they have a tax credit for the tax year of an amount equal to the RSCT withheld.

(7) **Tax credits related to personal service rehabilitation payments — providers [s LB 7]**

The provider has a tax credit for a tax year if:

(a) A person, who receives a personal service rehabilitation payment, pays another person (a provider) for providing a key aspect of social rehabilitation to them; or

(b) The ACC pays a provider a personal service rehabilitation payment for providing a key aspect of social rehabilitation to the person.

The amount of the credit is calculated using the formula:

\[(\text{Amount paid} \times \text{tax rate}) / (1 – \text{tax rate})\]

Where:

“Amount paid” is the amount paid to the provider (net of any tax withheld);

“Tax rate” is the rate of tax applying to the personal service rehabilitation payment under sch 4, Part I, cl 1, with the following exceptions:
(a) For a payment to which s RD 18 (schedular payment without notification) applies, the rate of tax is the rate under sch 4, Part I, cl 1 plus any additional amount required to be withheld under s RD 18;
(b) For a payment to which a special tax rate certificate applies, the rate of tax is the rate applying to the payment as determined by the CIR under s 24N of the TAA.

(8) Tax credits related to personal service rehabilitation payments — payers [s LB 8]
A person has a tax credit if the following conditions apply:
(a) The person is paid a personal service rehabilitation payment for a key aspect of social rehabilitation;
(b) The person pays another person (the provider) for providing the key aspect to them; and
(c) The amount paid to the provider is less than the amount of the personal service rehabilitation payment to the person after taking into account any amount of tax withheld.
The amount of the tax credit for a tax year is calculated using the formula:
\[
\text{total tax withheld} - \left(\frac{\text{amount paid} \times \text{tax rate}}{1 - \text{tax rate}}\right)
\]
Where:
“Total tax withheld” is the total amount of tax withheld from the personal service rehabilitation payment paid to the person;
“Amount paid” is the amount paid to the provider;
“Tax rate” is the rate of tax applying to the personal service rehabilitation payment under sch 4, Part I, cl 1, with the following exceptions:
(a) For a payment to which s RD 18 (schedular payment without notification) applies, the rate of tax is the rate under sch 4, Part I, cl 1 plus any additional amount required to be withheld under s RD 18;
(b) For a payment to which a special code applies, the rate of tax is the rate applying to the payment as determined by the CIR under s 24N of the TAA.

1395.45 Personal tax credits
The following tax credits are available to eligible individuals:

<table>
<thead>
<tr>
<th>Tax credit</th>
<th>Section</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>School child</td>
<td>LC 3</td>
<td>1395.55</td>
</tr>
<tr>
<td>Transitional tax</td>
<td>LC 4, LC 5</td>
<td>1395.60</td>
</tr>
<tr>
<td>allowance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Housekeeper</td>
<td>LC 6, LC 7, LC 8</td>
<td>1395.65</td>
</tr>
<tr>
<td>Charitable donations</td>
<td>subpart LD</td>
<td>1395.75</td>
</tr>
<tr>
<td>Payroll donations</td>
<td>LD 4 to LD 8</td>
<td>1395.77</td>
</tr>
<tr>
<td>Redundancy payments</td>
<td>subpart ML</td>
<td>1395.90</td>
</tr>
<tr>
<td>Absentees</td>
<td>LC 9</td>
<td>1000.35</td>
</tr>
<tr>
<td>Independent earner tax credit</td>
<td>LC 13</td>
<td>1395.70</td>
</tr>
</tbody>
</table>

Most tax credits are deducted from a person’s income tax liability for a tax year [ss BC 8(2), LA 2] in the order set out in s LA 4. The housekeeper and charitable donations tax credits are not deducted from the income tax liability because they are claimed under a separate process [see 1395.95]. The redundancy payment tax credit is also claimed separately [see 1395.90]. The payroll donations tax credit is refunded to the employee in the pay period in which the donation is deducted from their salary or wages [see 1395.77].
The deduction of personal tax credits from the income tax liability gives an equal benefit to all taxpayers, irrespective of the amount of their income. The tax credits are proportionally limited when allowed to an absentee [see 1000.35].

1395.55 School child tax credit [s LC 3]
A personal tax credit of up to $245.70 is deductible from the tax payable by a school child other than an absentee. “Absentee” is defined in 1000.10. To qualify for this tax credit, the person must, at any time in the tax year be younger than:
(a) 15 years; or
(b) 18 years and attending:
   (i) A private or state primary school, or a private or state secondary school, or department (as defined in the Education Act 1964); or
   (ii) An integrated school (as defined in the Private Schools Conditional Integration Act 1975); or
   (iii) A school providing special education (as defined in the Education Act 1964 and the Education Act 1989); or
(c) 19 years and:
   (i) During the previous tax year was a person to whom (b) applied;
   (ii) Turned 18 on or after 1 January in that previous tax year; and
   (iii) Continues to attend a school of any of the kinds referred to in (b).

The tax credit is the lesser of: $245.70 and an amount calculated by the formula:
\[
\text{Net income} - \text{Resident passive income} \times 10.5\%
\]

Where:
“Net income” is the person’s net income for the tax year;
“Resident passive income” is the resident passive income (ie New Zealand-sourced interest and dividends) derived by the person in the tax year.

A person cannot claim both the child tax credit and the transitional tax credit [s LC 4]. Without this tax credit the earnings of school children (eg from gardening, babysitting, or newspaper deliveries), would be taxed at the rate of 10.5 per cent (the lowest marginal rate of tax). The tax credit of $245.70 allows a child to earn $2,340 (not including interest and dividends) a year tax-free. The tax is claimed in the annual tax return, and like other non-refundable credits, cannot exceed the tax payable.

Example:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual gross income (including $200 interest)</td>
<td>$2,627.00</td>
</tr>
<tr>
<td>Tax on $2,627 at 10.5%</td>
<td>$275.84</td>
</tr>
<tr>
<td>Less school child tax credit:</td>
<td></td>
</tr>
<tr>
<td>($2,627 – $200) × 10.5% = $254.84</td>
<td></td>
</tr>
<tr>
<td>As $254.84 exceeds maximum tax credit, the maximum tax credit is claimed:</td>
<td>$245.70</td>
</tr>
<tr>
<td>Tax to pay</td>
<td>$30.14</td>
</tr>
</tbody>
</table>

In the year a child leaves school there is the choice of claiming either the child tax credit or the transitional tax allowance.

(1) Minor beneficiaries
If a child claiming a tax credit is a minor beneficiary of a trust (ie under 16 years of age at the trust balance date), the income received from the trust will not be included in the child’s net income for the purposes of calculating the tax credit. This is because any beneficiary income distributed to a minor is not included in
the assessable income of the minor, but is subject to tax in the hands of the trustees of the trust [s HC 17, see 1420.60].

1395.60 Transitional tax credit [ss LC 4, LC 5, LC 11, LC 12]

The transitional tax credit provides relief to those low income persons who would not otherwise qualify for tax credit relief under the family support legislation.

The tax credit is allowed to any person who in a tax year is engaged in full-time work, but not a person who:

(a) Is a child younger than 18 years, other than a child older than 15 who has stopped going to a school of any of the following kinds:
   (i) A private or state primary school, or a private or state secondary school, or department (as defined in the Education Act 1964);
   (ii) An integrated school (as defined in the Private Schools Conditional Integration Act 1975); or
   (iii) A school providing special education (as defined in the Education Act 1964 and the Education Act 1989);

(b) Is not resident in New Zealand throughout the tax year;

(c) Has a tax credit for the tax year under subparts MD, ME or MZ (which relate to tax credits under the family scheme); or

(d) Is throughout the tax year the spouse, civil union partner or de facto partner of a person [see 960.10] who has a tax credit for the tax year under subparts MD, ME or MZ .

A person who is engaged in full-time work for a week means a person who, in the week, is engaged in paid work for at least 20 hours. A person engaged in full-time work includes a person who is not engaged in paid work if they:

(a) Suffer incapacity due to personal injury by accident for which compensation is or will be paid, when otherwise they would have been engaged in paid work;

(b) Are on parental leave during a week for which a parental leave payment is payable under Part 7A of the Parental Leave and Employment Protection Act 1987; or

(c) Are temporarily, or for an indefinite period, incapacitated for work through sickness or accident in relation to which a sickness benefit is or will be paid under the Social Security Act 1964, when otherwise they would have been engaged in paid work.

If a person performs paid work in a pay period that consists of a period longer than one week, the person is treated as having been engaged in paid work at a uniform daily rate throughout that pay period.

“Paid work” means work from, by, or through the performance of which a person derives assessable income.

A taxpayer who was remunerated for only 10 hours work per week but who in fact worked more than 20 hours per week was a full-time earner and entitled to claim the transitional tax allowance: *TRA Case S52* (1996) 17 NZTC 7,343.

The tax credit is calculated in accordance with the following formula:

\[ \text{person’s net income} \times \frac{\text{weekly periods}}{52} \]

Where:

“Person’s net income” is

(a) $611.52, if the net income of the person for the tax year is less than $6,241; or

(b) If the net income of the person for the tax year is $6,241 or more, an amount calculated using the following formula:

\[ \$611.52 - \left( \text{person’s net income} - \$6,240 \right) \times 0.168 \]

Where:

“Person’s net income” is the person’s net income for the tax year in complete dollars.
“Weekly periods” is the number of periods of one week for which the person is engaged in full-time work. When a full-time earner is a non-resident for part of a tax year, the net income earned while that person is personally present in New Zealand is grossed up in the proportion that the number of days in the income year bears to the number of days in the period of personal residence. The credit is then apportioned on the basis of the number of days the person is resident in New Zealand [s LC 11].

Example:
Person A, a full-time worker, is personally present in New Zealand for 100 days during the tax year and derives net income of $2,000 during that period. The “grossed up” net income is calculated as follows:

\[
\begin{align*}
\text{Number of days in the income year} & = 365 \\
\text{Divided by number of days A is personally present in New Zealand} & = 100 \\
\text{Gross up factor} & = 3.65 \\
\text{Multiplied by net income earned while A is personally present in New Zealand} & = 2,000 \\
\text{Grossed up net income} & = 7,300 \\
\end{align*}
\]

\[
\text{Tax credit on grossed up net income: } \frac{611.52 - (7,300 - 6,240) \times 0.168}{7,300} = 433.44
\]

\[
\text{Allowable tax credit: } \frac{433.44 \times 100}{365} = 118.75
\]

The CIR is granted discretion under s LC 12 to determine the net income of a person who is not a New Zealand resident throughout the whole of the tax year.

1395.65 Housekeeper or childcare [ss LC 6, LC 7, LC 8]
The housekeeper tax credit provides a partial subsidy for the cost of a housekeeper or childcare in certain circumstances. It is not affected by household income. The tax credit is claimed by completing a credit claim form [see 1395.90]. The housekeeper tax credit is a refundable tax credit under s LA 7. Refunds of the tax credit are paid by direct credit to the taxpayer’s bank account.

The tax credit for a tax year is 33 per cent of every complete dollar of housekeeping payments made during the tax year by a person other than an absentee. The maximum tax credit allowed is $310, which is reached when total housekeeping payments equal or exceed $940.

“Housekeeping payments” are payments that are made by the person during the tax year for the services of a housekeeper, and for which no credit under any other provision of ITA 2007 is allowed to the person or to any other person.

“Housekeeper” means for a person (person A) and a tax year:

(a) If person A is a widow, a widower, a surviving civil union partner, a surviving de facto partner, a divorced person, a person whose civil union has been dissolved, a person who is not in a marriage, civil union, or de facto relationship, or a separated person:

(i) A person or an institution that has the care and control of a household member, either in person A’s home or elsewhere; or

(ii) A person who tends person A’s home if the person’s services are necessary because of a mental or physical infirmity or disability of person A; or

(b) If person A is living with their spouse, civil union partner, or de facto partner:

(i) A person or an institution that has the care and control of a household member, either in person A’s home or elsewhere, if the services of the person or the institution are necessary because of a mental or physical infirmity or disability of person A or their spouse, civil union partner, or de facto partner; or

(ii) A person who tends person A’s home, if the services of the person or the institution are necessary because of a mental or physical infirmity or disability of person A or their spouse, civil union partner, or de facto partner; or
(c) If person A is living with their spouse, civil union partner, or de facto partner, a person or an institution that has the care and control of a household member, either in person A’s home or elsewhere, if the services of the person or the institution are necessary because of the employment or business activities of both person A and their spouse, civil union partner, or de facto partner [s LC 7].

“Household member” means a person who is younger than 18 or is suffering from a mental or physical infirmity or disability affecting their ability to earn a living.

“Institution” means a creche, day nursery, play centre, kindergarten, or similar body. It does not, in relation to the care and control of a household member who is five or older, include an institution that is, in any way, concerned with the education of the household member.

“Home”, for a person and a tax year, means the dwelling in which the person resides during the tax year. It does not include a motel, hotel, boardinghouse, guest house, convalescent home, nursing home, rest home, hospital, hospice, or other similar establishment, other than a part of an establishment that is occupied by any person regularly engaged in carrying on the activity of operating the establishment or by the person’s spouse, civil union partner, or de facto partner [s LC 8].

Example 1:
Rita, a solo mother, works part-time while her daughter is at a creche. During the income year, Rita paid creche fees of $1,000.47. The tax credit is calculated as 33 per cent of $1,000, or $330. As this exceeds the $310 maximum, her credit is limited to $310. Note that Rita would qualify for the credit even if she did not work.

If a person and their spouse both qualify for the tax credit, the CIR may apportion the amount of the credit as is fair and equitable, up to the $310 overall maximum [s LC 7].

Example 2:
Ron and Nancy, a married couple who both work, have a physically disabled child who requires constant care. During the income year they each paid $3,000 for a person to look after their child at home. Ron and Nancy both qualify for the housekeeper tax credit, but because the amount they have paid far exceeds the maximum, they will each be entitled to claim $155 (50 per cent of $310).

The tax credit is allowed against income from personal services on a proportionate basis for absentees [see 1000.35].

1395.70 Independent earner tax credit [s LC 13]
The independent earner tax credit (IETC) is available from 1 April 2009 to New Zealand resident individuals who do not receive an income-tested benefit, a veteran’s pension or New Zealand superannuation, and who are not (either directly, or through their spouse or partner) entitled to a WFF tax credit. In addition, the person (or their spouse or partner) must not be in receipt of any similar benefit granted outside New Zealand.

The amount of the credit is calculated using the formula:

\[
(person’s credit – full year abatement) \times \text{credit period month/12}
\]

Where:

“Person’s credit” is $520 if the person’s net income for the tax year is $24,000 or more. If net income is less than $24,000, the credit is zero.

“Full year abatement” is 13 cents for each complete dollar of net income in excess of $44,000.

“Credit period months” is the number of whole months in the tax year that the person meets the qualifying criteria set out above.

The effect of the abatement is that the credit is not available to person’s whose net income equals or exceeds $48,000. The full year entitlement can be summarised as follows:

<table>
<thead>
<tr>
<th>Net income</th>
<th>Amount of IETC</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 - $24,000</td>
<td>Nil</td>
</tr>
<tr>
<td>$24,000 - $44,000</td>
<td>$520</td>
</tr>
</tbody>
</table>
**Tax Credits**

### Net income  
**Amount of IETC**

- $44,001 - $48,000: $520 – ((net income – $44,000) × 0.13)
- Over $48,000: Nil

Employees receive the benefit of the IETC by way of reduced PAYE deductions. Non-employees claim the credit by filing a tax return or requesting a personal tax summary.

### 1395.75 Charitable donations [subpart LD]

#### (1) Calculating and claiming the tax credit

A person who makes a charitable or other public benefit gift in a tax year, and who applies for the credit as required by s 41A of the TAA, has a tax credit for the tax year equal to the amount calculated under the formula:

\[
\text{total gifts} \times 33\frac{1}{3}\%.
\]

Where:

“Total gifts” means the total amount of all charitable or other public benefit gifts made by the person in the tax year.

A credit under s LD 1 is a refundable tax credit under s LA 7. The credit is not used under ss LA 2 to LA 6 to reduce the person’s income tax liability.

#### (2) Exclusions [s LD 2]

The following persons cannot claim a charitable donations tax credit:

- An absentee;
- A company;
- A public authority;
- A Maori authority;
- An unincorporated body;
- A trustee liable for income tax under subpart HC, and s HZ 2 (which relate to trusts and distributions from trusts);
- In relation to the credit, a person who has a tax credit for a payroll donation.

#### (3) Meaning of charitable or other public benefit gift [s LD 3]

A “charitable or other public benefit gift”:

- Means a gift of $5 or more that is paid to a society, institution, association, organisation, trust, or fund, described below or listed in sch 32 (see list below);
- Includes a subscription paid to a society, institution, association, organisation, trust, or fund, only if the subscription does not confer any rights arising from membership in that or any other society, institution, association, organisation, trust, or fund; and
- Does not include a testamentary gift.

The following are the entities referred to in (a) above:

- A society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual, and whose funds are applied wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand;
- A public institution maintained exclusively for any one or more of the purposes within New Zealand set out in (a);
- A fund established and maintained exclusively for the purpose of providing money for any one or more of the purposes within New Zealand set out in (a), by a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual;
(d) A public fund established and maintained exclusively for the purpose of providing money for any one or more of the purposes within New Zealand set out in (a).

The fact that an organisation is not registered with the Charities Commission [see 150 CHARITIES] does not necessarily mean that a person making a charitable donation to that organisation is prevented from claiming a tax credit. A tax credit will be available provided the organisation has Inland Revenue-approved donee status, which depends on the organisation meeting the requirements of s LD 3(2). An organisation can have Inland revenue-approved donee status without being registered with the Charities Commission.

The payment of a tertiary student association fee is not a gift for the purposes of s LD 3 where any rights arising from membership are conferred by the payment and/or where the payment is compulsory. Accordingly, a tax credit is not available under s LD 1. However, if a person who is not a student makes a donation to a student association and no rights are conferred because of the payment, a gift is made and a tax credit is allowed. If the payment of a student association fee is voluntary and does not confer any rights upon the student, a tax credit will be available [see Public ruling BR Pub 05/11, TIB vol 17:5 (June-July 2005) at 31].

Receipts for gifts must be furnished with the tax credit claim form [see 1395.95]. The payments must be made in the tax year, that is, from 1 April to 31 March. The receipts need only be for the total amount donated during the income year. A formal receipt, although desirable, is not essential. An acknowledgement is acceptable provided it shows the name of the organisation receiving the payment, the name of the payer, the amount and date of the payment or other data signifying the amounts paid within the income year. Certificates given by members of the New Zealand Institute of Chartered Accountants may be accepted in place of receipts.

If a tax agent completes a taxpayer’s tax credit claim, receipts do not have to be supplied with the claim form if the tax agent has sighted the receipts and the taxpayer retains them for four income years after the year of claim.

Receipts are often issued made out to “Mr and Mrs”, which the CIR will accept without further inquiry. If both husband and wife are deriving income they may each claim up to the maximum tax credit and seek to split the donation between them, which is permissible. Where the receipt is attached to the return of one spouse [see 960.10] and the receipt is in the name of the other spouse, the claim will also be admitted.

The CIR has indicated that church offerings come within the spirit of definition of “charitable purpose”.

It is understood that some members of Jewish congregations pay an annual subscription which entitles them to a particular seat. In addition, they may pay further amounts by way of envelope collections. The subscription paid under the first arrangement is normally applied for general church purposes and will qualify for the donations tax credit in the same way as the envelope contributions.

“Charitable purpose” includes every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community. The purpose of a trust, society, or institution is charitable under the ITA 2007 if the purpose would meet the public benefit requirement apart from the fact that the beneficiaries of the trust, or the members of the society or institution, are related by blood. A marae has a charitable purpose if the physical structure of the marae is situated on land that is a Maori reservation referred to in the Te Ture Whenua Maori Act 1993 (Maori Land Act 1993); and the funds of the marae are not used for a purpose other than the administration and maintenance of the land and of the physical structure of the marae, or not used for a purpose that is a charitable purpose other than under this paragraph [s YA 1].

In Molloy v Commissioner of Inland Revenue (1981) 5 NZTC 61,070, (1981) 5 TRNZ 1 (CA), the taxpayer claimed a special exemption for a donation to the New Zealand Society for the Protection of the Unborn Child (SPUC) which the CIR disallowed on the ground that the funds of the Society were not “applied wholly or principally to any charitable, benevolent, philanthropic or cultural purpose within New Zealand”.

It was held that funds are not disbursed for charitable purposes if the dominant purpose or one of the dominant purposes of a society is political. If an object of a society was to change law or to oppose a change in the law,
it was a political object and it could not be said that the application of its funds were principally for charitable or cultural purposes.

According to Inland Revenue’s information sheet (IR525), donations to the following organisations will qualify for the tax credit:

(a) Approved charitable organisations;
(b) Approved New Zealand religious organisations;
(c) Medical research schools and universities;
(d) Approved overseas aid funds;
(e) Free Kindergarten Associations;
(f) State schools, school boards of trustees or parent–teacher associations (To qualify, the school must be a state school (this includes integrated schools) or be approved as a charity for tax purposes. Payments must be donations, not payment of school fees);
(g) State-funded schools for payment of fees, as long as these go to the school’s general fund.

Tuition or tertiary fees do not qualify for the credit. Some school activities are deductible. However, you cannot claim for:

(a) Payments for classes where there is a take-home component (eg woodwork);
(b) Where attendance at (or participation in), an activity is voluntary;
(c) Transport to or from a school activity (eg a camp), or food at the camp.

Gifts made by partnerships to approved organisations are allowed to the individual partners in proportion to their respective shares in the partnership. Where one of the partners is a company, this partner’s share of the amount contributed is non-deductible expenditure of the partnership (as is the whole donation for that matter) and may not be spread among the other members of the partnership for the purposes of their claim for a tax credit.

Example:
A, B, C, and X Co Ltd are partners in a business. The partnership makes a gift of $200 to an approved organisation. Each partner has contributed $50 each. This $200 is non-deductible to the partnership. The three individual partners may each claim 33 per cent of their $50 as a tax credit. However, the fourth partner (X Co Ltd), cannot claim for its $50 share since the tax credit is not available to companies.

Donations to the following specific organisations (listed in sch 32) qualify for the tax credit:

- Adventist Development and Relief Agency
- African Enterprise (New Zealand) Aid and Development Fund
- Akha Rescue Ministry Charitable Trust
- Alhay Buhay Foundation Trust
- Amnesty International
- Bangladesh Flood Appeal Trust
- Books for Africa
- Caritas Aotearoa-New Zealand
- Channel 2 Cyclone Aid for Samoa
- Cheboche Area Trust Incorporated
- Children on the Edge (New Zealand) Trust
- Christian Blind Mission International (New Zealand)
- Childfund New Zealand Limited
- Christian World Service
- Community Action Overseas (Oxfam New Zealand)
- CORSO (Incorporated)
- Cry for the World Foundation New Zealand Humanitarian Aid Fund
- Cure Kids
• Cyclone Of a Relief Fund
• Cyclone Val Relief Fund
• DIPS’N Charitable Trust (International)
• Educational Aid for International Development Trust Board
• Four Sherpa Trust
• Global Hope
• Greater Mekong Subregion Tertiary Education Consortium Trust
• Habitat for Humanity New Zealand Limited
• Hamlin Charitable Fistula Hospitals Trust
• Help a Child Foundation New Zealand
• Hope Foundation Development Trust
• Hope International Charitable Trust
• Ingwavuma Orphan Trust Fund of New Zealand
• International Christian Aid (ICA)
• Jasmine Charitable Trust No 2 (from 2013 tax year)
• Karunai Illam Trust
• Kyrgyzstan New Zealand Rural Trust
• Limbs 4 All Charitable Trust
• L Women of Africa Fund
• Medicine Mondiale
• Mission Without Borders (New Zealand), Humanitarian Aid Account
• Mobility Equipment for the Needs of Disabled Trust
• Nelson Mandela Trust (New Zealand)
• New Zealand Disaster Assistance Response Team Trust
• New Zealand Good Samaritan Heart Mission to Samoa Trust (from 2013 tax year)
• New Zealand Jesuits in India Trust
• New Zealand Sports Foundation (Incorporated)
• New Zealand Viet Nam Health Trust
• NZ-Iraqi Relief Charitable Trust (from 2013 tax year)
• Open Home Foundation International Trust
• Operation Hope (Aid Ship to Africa)
• Operation Restore Hope Charitable Trust
• Operation Vanuatu Charitable Trust
• Partners Relief and Development New Zealand
• Plan New Zealand
• “Raphael” (The Ryder-Cheshire Foundations of New Zealand)
• Register of Engineers for Disaster Relief New Zealand
• RNZWCS Limited (from 2013 tax year)
• Ruel Foundation (from 2013 tax year)
• Sampoerna Foundation Limited
• Save the Children New Zealand (and its branches)
• Sport and Recreation New Zealand
• St Stanislas Charitable Trust of New Zealand
• Surf Aid International Incorporated
• Te Tuao Tawahi: Volunteer Service Abroad Incorporated
• Tender Trust
• The Band Aid Box
• The Cambodia Charitable Trust (from 2013 tax year)
• The Bougainville Library Trust [from the 2011-2012 to 2018-2019 tax years]
• The Branch Foundation
Tax Credits

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- The Commonwealth Foundation
- The Destitute Children’s Home, Pokhara, Charitable Trust
- The Evangelical Alliance Relief Fund (TEAR Fund)
- The Fred Hollows Foundation (New Zealand)
- The Food Bank of New Zealand
- The Hillary Himalayan Foundation
- The Leprosy Mission New Zealand Incorporated
- The Mutima Charitable Trust [from the 2011-2012 to 2016-2017 tax years]
- The New Zealand Council of the Ramabai Mukti Mission Trust Board
- The New Zealand Rotary Clubs Charitable Trust
- The New Zealand Society for the Intellectually Handicapped (Incorporated)
- The Sir Edmund Hillary Trust
- The Sir Walter Nash Vietnam Appeal
- The Unions Aotearoa International Development Trust (from 2013 tax year)
- The United Nations International Children’s Emergency Fund (UNICEF)
- The Winston Churchill Memorial Trust
- The World Swim for Malaria Foundation (New Zealand)
- Together for Uganda
- Triyog Himalaya Trust
- UNHCR (United Nations High Commissioner for Refugees)
- Valehead Community Health Centre Trust
- Water for Survival
- Waterharvest Trust
- World Vision of New Zealand (Incorporated)
- Zonta International District 16 (New Zealand) Charitable Trust

See 150.70 for the criteria and procedure to apply for listing in sch 32.


(4) Approval for charities and donee organisations

Organisations seeking confirmation of donee status or charitable exemption should write to Inland Revenue stating the types of exemption sought and providing the following details:

(a) An up-to-date, signed copy of the organisation’s rules, constitution, trust deed or other founding document;
(b) A copy of the organisation’s certificate of incorporation (if applicable); and
(c) Details of how the organisation has been (or will be) operating.

Overseas organisations should write to Inland Revenue’s Non-resident Centre, Private Bag 1932, Dunedin. Refer to the Inland Revenue Booklet Charitable organisations (IR255), for details of the criteria that must be met by organisations seeking charitable donee status and charitable exemptions.
1395.77  Payroll donations [ss LD 4, LD 5, LD 6, LD 7, LD 8, RD 13B; TAA, s 24Q]

(1) Payroll donation tax credit

The voluntary payroll giving scheme enables employees to make regular donations to charitable organisations of their choice by way of deduction from their salary or wages, and to receive the immediate benefit of the charitable donations tax credit without the need to obtain and keep receipts. The donations are passed on to the charities by the employer or PAYE intermediary.

The scheme is voluntary. Employers have the option of whether or not to offer this service to their employees; and employees have the choice of whether to participate in the scheme. Only employers who file their employer monthly schedules and PAYE income payment forms electronically can participate in the payroll giving scheme. The scheme takes effect from 7 January 2010.

(2) Amount of credit [ss LD 4, LD 8]

An employee is entitled to a tax credit for a pay period equal to:

\[
\text{total donations} / 3
\]

Where:

“Total donations” is the total amount of all payroll donations made by the person in the pay period.

A “payroll donation” is an amount that an employee asks their employer to transfer from their pay to a donee organisation. A “donee organisation” is any entity described in s LD 3(2) or listed in sch 32 [see 1395.75].

The employee who is making the donation is responsible for:

(a) Checking that the recipient of the donation is a donee organisation; and

(b) Providing the employer with sufficient details of the recipient to enable the transfer to be made [s 24Q of the TAA].

The amount of the tax credit must not exceed the amount of tax for the employee’s pay for the period. The credit is a non-refundable tax credit [see 1395.10]. A person who has received a tax credit for a payroll donation cannot apply for a refund in relation to the same donation under ss LD 1 and 41A of the TAA [see 1395.75, 1395.95]. A person may make a payroll donation for a pay period only after satisfying any tax obligation they may have, or any statutory or legal requirement they may be obliged to meet from their PAYE income payment (eg student loans or child support).

Example 1:

Ann makes regular weekly donations of $20 to her church. She has asked her employer, who offers a payroll donation facility, to deduct the donations from her salary and forward them on to the church so that she can receive the benefit of the tax credit in her weekly pay. Ann’s gross weekly salary is $960 and the tax on this amount is $173.35. The tax credit is one-third of the amount of the donation, or $6.67. The employer will pay $166.68 ($173.35 less $6.67) to Inland Revenue. Ann’s net salary is:

| Gross salary | $960.00 |
| Less tax     | $173.35 |
| Less donation| $20.00  |
|              | $766.65 |
| Plus tax credit for donation | $6.67 |
| Net salary   | $773.32 |

Example 2:

Kevin is a fanatical animal rights activist. Every week, he donates $235 to the SPCA and other approved charities that benefit animals. He lives with his mother and so is able to survive on very little income. Kevin has arranged for his employer, who offers the payroll donation facility to staff, to deduct the donations from his wages and forward them on to the various charities. Kevin’s weekly wage is $425. Tax on this amount is $64.19. The tax credit is calculated as one-third of the total donations, or $78.33. However, since this figure exceeds the amount of tax, the tax credit is limited by s LD 4(4) to $64.19. Kevin’s employer will not have to pay any tax to Inland Revenue for Kevin’s wages because the tax credit equals the amount of tax. Kevin’s net wages are:
Tax Credits

Gross salary $425.00
Less tax $64.19
Less donation $235.00
Plus tax credit for donation $64.19
Net salary $190.00

(3) Meaning of “pay” [s LD 4(7)]
For payroll donation purposes, “pay” means a payment of salary, wages, or allowances made to a person in connection with their employment, and includes:
(a) A bonus, commission, gratuity, overtime pay, or other pay of any kind; and
(b) Any similar amount earned by an employee in the normal course of their employment.

(4) Employer’s responsibilities [ss LD 5, RD 13B; TAA, s 24Q]
The employer is responsible for calculating the amount of the credit. The employer or PAYE intermediary must subtract the amount of the tax credit from the PAYE for the pay period and record the information in the employer monthly schedule.

The employer must transfer the amount of the donation to the donee organisation by the PAYE due date (as specified in ss RA 15 and RD 4) that falls nearest to two months after the end of the pay period [see 1080.80 to 1080.83]. The employer holds the amount on trust for the employee until it is transferred to the donee organisation.

(5) Credit may be extinguished [ss LD 6, LD 7]
A tax credit for a payroll donation is extinguished when:
(a) The employer or a PAYE intermediary transfers the donation to an entity that is not a donee organisation; or
(b) The payroll donation is, for whatever reason, returned to the employee.

The extinguished credit is removed from the employee’s tax credits for PAYE income payments, and if the extinguishing of the credit results in a tax shortfall the employee is liable to pay the shortfall to the CIR under s RD 4 [see 1080.85].

1395.90 Redundancy payments [subpart ML; TAA, s 41B]
A person who derives a redundancy payment before 1 October 2011 has a tax credit equal to six cents for each complete dollar of total redundancy payments derived by them before 1 October 2011. It does not matter whether a redundancy payment is paid in a lump sum or by instalment, or whether the total redundancy payments relate to one or more occasions of redundancy. However, the maximum credit that a person has for each occasion of redundancy is $3,600.

A “redundancy payment” is a PAYE income payment [see 1080.10] paid to a person whose employment in a position is terminated because the position has become superfluous to the requirements of the employer, and the payment is in compensation for the loss of the person’s employment [s YA 1].

A tax credit is not allowed for a redundancy payment:
(a) Related to:
(i) Retirement from employment;
(ii) Loss of seasonal employment arising from the normal seasonal work cycle;
(iii) A contract of employment for a fixed term or for the duration of a project;
(iv) Employment for a period following notice of termination of employment; or

(b) Paid:

(i) To a director of a company by the company or a person associated with the company;
(ii) To a person by a person associated with them; or
(iii) By a person to an employee who has been paid a redundancy payment by a person associated with the person.

A person who is entitled to a redundancy payment tax credit must apply to the CIR for a refund. The CIR cannot pay the credit until the person applies for it as required under s 41B of the TAA. An application for a refund must be made within four years of the date of the redundancy payment.

The tax credit applies to redundancy payments paid on or after 1 December 2006 and before 1 October 2011.

1395.95 Application for refund of housekeeper and charitable donations tax credits [TAA, s 41A]

The housekeeper and charitable donations tax credits [ss LC 6, LD 1] are claimed by completing a tax credit claim form (IR526). A taxpayer can submit more than one claim form, but the total amount refunded by Inland Revenue cannot exceed the annual amount of the tax credits [see 1395.65 and 1395.70].

If the sum of the payments which qualify for the tax credits exceeds the taxpayer’s taxable income for the preceding tax year, Inland Revenue must reduce, in equal portions, the total amount of qualifying payments to the amount of the taxpayer’s taxable income for the tax year in which the payments were made.

Example:
Chris’s taxable income for the previous tax year was $2,000. During the current tax year, Chris made total qualifying payments under s LC 6 of $900 and total qualifying donations under s LD 1 of $1,500. Because the total of the qualifying payments under both tax credits ($2,400) cannot exceed the previous year’s taxable income, Inland Revenue will limit the total of both to $2,000. As this must be done on a pro rata basis, the qualifying payments under s LC 6 will be reduced to $750 ($900 × 2,000 / 2,400) and the qualifying donations under s LD 1 will be reduced to $1,250 ($1,500 × 2,000 / 2,400). Chris will therefore be entitled to a tax credit under s LC 6 of $247.50 ($750 × 0.33) and a tax credit under s LD 1 of $416.67 ($1,250 / 3). His total refund will be $664.17 ($247.50 + $416.67).

In completing a claim form, a taxpayer must provide details of qualifying payments for each tax credit.

Standard and early balance date taxpayers can apply for a refund for a tax year from 1 April following the end of the taxpayer’s income year. Late balance date taxpayers can apply for a refund for a tax year from the first day of the taxpayer’s next accounting year. In special circumstances, the CIR may accept an application for a refund before the end of the tax year. Special circumstances include a taxpayer leaving New Zealand permanently or for a significant length of time, and a trustee of a deceased person’s estate who wishes to wind up the estate.

Inland Revenue has stated that it will process early tax credit claims in circumstances where having to make a claim during the claim period would significantly disadvantage or inconvenience the taxpayer (eg when the taxpayer has been incapacitated or out of the country during most of the tax credit claim period) [see TIB vol 12:12 (December 2000) at 60].

Following receipt of a claim form, Inland Revenue must notify the taxpayer of the amount of tax credits allowed and the amount of refund allowed. An allowable refund must be paid as if it were tax paid in excess [see 1215.10]. Refunds must be made by direct credit to a bank account nominated by the taxpayer, unless this would cause undue hardship [TAA, s 184A]. The claim form will therefore require the taxpayer to provide bank account details.

If overpaid, a refund is recoverable by Inland Revenue as an excess credit of tax under s 142D of the TAA [see 1110.205].

Use of money interest (UOMI) does not apply to refunds or excess refunds made under s 41A of the TAA. However, applications made under this section are subject to the penalties rules.

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Chapter 1400
Trading Stock

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1400.05 General rules

The trading stock rules are applicable to all business trading stock. The key features of the rules are:

(a) Trading stock is valued under subpart EB.
(b) The closing value of trading stock is income.
(c) The opening value of trading stock is an allowable deduction.
(d) Closing stock can be valued at cost or market selling value, but market selling value can only be used if it is less than cost.
(e) Low-turnover traders (those with an annual turnover of less than $3 million), can use market selling value even if it exceeds cost.
(f) Excepted financial arrangements (eg shares and options), held as trading stock must be valued at cost.
(g) Taxpayers, other than low-turnover traders, who value trading stock at cost must follow generally accepted accounting practice and, in particular, must comply with NZ IAS-2 Inventories and the consistency and disclosure requirements of NZ IAS-8: Accounting Policies, Changes in Accounting Estimates and Errors. Separate rules for valuing stock at cost apply to low-turnover traders.
(h) Only the first-in first-out (“FIFO”) or weighted average methods of assigning costs may be used, and the method chosen must be the same as that used by the taxpayer to prepare financial statements. Low-turnover traders must use the same cost-flow method consistently from year to year.
(i) Discounted selling price and replacement price may be used to determine cost by taxpayers who use the same method in their financial statements or by low-turnover traders who do not prepare financial statements.

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(j) Taxpayers whose turnover for the income year does not exceed $1.3 million are permitted to use the value of opening stock as being the value of closing stock, provided that the taxpayer reasonably estimates that the true value of closing stock is less than $10,000.

(k) Livestock, unless held as trading stock, is valued under subpart EC.

**1400.10 Effect of trading stock on net income** [ss CH 1, DB 49, EB 1, EA 1(1), EB 3]

Taxpayers that own or carry on a business must take the value of trading stock into account in calculating their net income or loss for the year. This includes excepted financial arrangements such as shares and a share supplier’s share-lending right under a share-lending arrangement. A share-lending right is valued at the cost of the original share.

The value of closing stock is added to income for the year, and the value of opening stock is deducted from income for the year. The value of opening stock for an income year is the value of closing stock at the end of the previous income year. This reflects the cost of goods sold calculation typically used in calculating gross profit for an entity.

**Example:**

<table>
<thead>
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<th>Item</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$50,000</td>
</tr>
<tr>
<td>Less cost of goods sold</td>
<td></td>
</tr>
<tr>
<td>Opening stock</td>
<td>$5,000</td>
</tr>
<tr>
<td>Plus purchases</td>
<td>$20,000</td>
</tr>
<tr>
<td>Less closing stock</td>
<td>$7,000</td>
</tr>
<tr>
<td>Gross profit</td>
<td>$18,000</td>
</tr>
<tr>
<td></td>
<td>$32,000</td>
</tr>
</tbody>
</table>

Because closing stock increases net income, taxpayers will (given the opportunity) tend to value closing stock at the lowest possible value. The trading stock rules provide only limited opportunities for tax planning.

The value of closing stock is calculated using one or more of the methods explained below [see 1400.20].

**1400.15 Definitions** [ss EB 2, EB 13(2)]

“Trading stock” is property that a person who owns or carries on a business has for the purpose of selling or exchanging in the ordinary course of business. It includes:

(a) Work in progress or partially completed work which, if completed, would be trading stock;

(b) Materials held by a taxpayer for use in the manufacture or production of trading stock;

(c) Anything for which expenditure has been incurred that, if possession of it were taken, would be trading stock (eg stock in transit);

(d) Livestock; and

(e) An asset subject to hire purchase that is deemed to have been acquired by the lessor under s FA 15, if the asset is a business asset of the lessor (eg repossessions) [see 640.10].

The following are not trading stock:

(a) Land;

(b) Depreciable property [see 250.18];

(c) Financial arrangements subject to the financial arrangement rules or the old financial arrangement rules;

(d) An excepted financial arrangement of a life insurer;

(e) Livestock not used in a dealing business;
(f) Consumable aids which are to be used in the production of trading stock;
(g) Spare parts, unless held for sale or exchange;
(h) Excepted financial arrangements in the form of investment shares held by a portfolio investment entity (PIE), the New Zealand Superannuation Fund, or a life insurer in its capacity as a life fund PIE if the proceeds from the sale of the share would be excluded income under s CX 55;
(i) An emissions unit; and
(j) A non-Kyoto greenhouse unit.

Services generally are not included in trading stock. However, some services, such as inward freight, are included in the cost of trading stock.

The above definition does not apply for all aspects of the trading stock rules. Some provisions have modified definitions of trading stock. Where appropriate, these modified definitions are explained.

A “low-turnover trader” is one whose turnover in an income year does not exceed $3 million. In determining whether turnover has exceeded $3 million, the turnover of persons associated with the taxpayer is also included. “Associated person” is limited to relationships referred to in ss YB 2 and YB 3 [see 70.20 to 70.35]. Under this rule, taxpayers will be associated only if they are two companies that have at least 50 per cent common ownership, or one of them is a company and the other is a person (other than a company) who has at least 50 per cent ownership of that company.

TaxNote: Taxpayers other than “low-turnover traders” are referred to in the following commentary as “high-turnover traders”. This is not a statutory term but is used here to refer to a taxpayer whose turnover (including that of any associated person) in an income year exceeds $3 million.

1400.20 Valuation methods [ss EB 3, EB 4, EB 13, EB 14, ED 1(1)]

The options available to a taxpayer for valuing closing stock depend on two main factors:
(a) Whether the taxpayer is a low-turnover trader or a high-turnover trader; and
(b) Which method of valuing trading stock the taxpayer uses in its financial statements (if financial statements are prepared).

(1) High-turnover traders [ss EB 3, EB 4]

High-turnover traders may value closing stock (other than excepted financial arrangements), at:
(a) Cost [see 1400.30];
(b) Replacement price (if used in the taxpayer’s financial statements) [see 1400.45];
(c) Discounted selling price (if used in the taxpayer’s financial statements) [see 1400.40]; or
(d) Market selling value (if lower than cost) [see 1400.50].

These four methods are known as the “standard valuation methods” for trading stock. High-turnover traders are not compelled to use market selling value if it is lower than cost (as would be the case under NZ IAS-2).

(2) Low-turnover traders [ss EB 13, EB 14]

Low-turnover traders may value closing stock (other than excepted financial arrangements), at:
(a) Any of the “standard valuation methods” available to high-turnover traders (see above); or
(b) Any of the “low turnover valuation methods” being:
   (i) Cost for low-turnover traders [see 1400.35];
   (ii) Replacement price for low-turnover traders [see 1400.45];
   (iii) Discounted selling price for low-turnover traders [see 1400.40]; or
   (iv) Market selling value for low-turnover traders [see 1400.55]; or
(c) As “low value trading stock” [see 1400.35].

These methods are explained below.
The same valuation method does not have to be used for all trading stock held by a taxpayer. According to the CIR, taxpayers may use one or more valuation methods to value their closing stock. They may use a cost valuation method for some stock and market selling value for other stock that has a value less than cost. Taxpayers may also use more than one cost valuation method to value closing stock. However, it is generally expected that taxpayers will apply the same cost valuation method to groups of similar or related items of trading stock. For example, a manufacturer might use cost to value most stock and discounted selling price for stock sold in a factory shop [see TIB vol 10:12 (December 1998) at 22].

Trading stock which consists of excepted financial arrangements, such as shares, must be valued at cost [s ED 1(1), see 1400.60].

Livestock which is held as trading stock (ie for dealing operations) is valued using the same rules as for other trading stock. However, all other livestock must be valued under subpart EC [see 430.60].

1400.30 Cost — high-turnover traders [ss EB 6, EB 7, EB 8, EB 12]

Cost may be used for valuing any trading stock. However, for the treatment of excepted financial arrangements [see 1400.60]. Cost must be determined according to NZ IAS-2: Inventories. This is intended to reduce compliance costs by enabling taxpayers to adopt for tax purposes stock valuations used in their financial statements. Taxpayers valuing closing stock using a cost valuation method must also comply with the consistency and disclosure requirements of NZ IAS-8: Accounting Policies, Changes in Accounting Estimates and Errors [s EB 12]. The New Zealand International Accounting Standards (NZ IAS) should be read in conjunction with the New Zealand Preface and the New Zealand Equivalent to the IASB Framework for the preparation and Presentation of Financial Statements (NZ Framework). These documents are available from the New Zealand Institute of Chartered Accountants (NZICA). NZ IAS-2 does not apply to work in progress under a construction project or financial instruments, or inventories held by producers of minerals or mineral products. Neither does it apply to biological assets and agricultural produce (see below).

NZ IAS-2 states that the cost of inventories is the total of the cost of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition. Cost of purchase includes (in addition to the actual cost of the goods themselves):

(a) Import duties and other purchase taxes (other than those which are subsequently recoverable);

(b) Transport and handling costs;

(c) Any other directly attributable costs of acquisition; and

(d) Deductions for immediate or deferred discounts (other than settlement discounts), rebates, and subsidies received.

Cost of conversion includes:

(a) The cost of labour (including any charges directly incurred in connection with such labour) and of subcontract work; and

(b) Other production costs.

Costs of conversion include a systematic allocation of those production overheads that relate to putting the inventories in their present location and condition. The systematic allocation of those production overheads must be based on the capacity of the production facilities. Overheads other than production overheads must be included as part of cost of inventory only to the extent to which they relate clearly to putting the inventories in their present location and condition. The cost of items of inventory segregated for specific projects and the cost of items of inventory that are not ordinarily interchangeable must be ascertained by using specific identification of their individual costs. The cost of all other items of inventory must be ascertained by using the first-in, first-out (FIFO) cost formula or the weighted average cost formula.

According to Inland Revenue, some of the costs to be included in trading stock under NZ IAS-2 (eg depreciation or repairs and maintenance), may be different from the amounts allowed for tax purposes. The
accounting values of costs such as depreciation are only relevant for tax purposes for calculating the value of closing stock. For all other purposes, the specific provisions in the ITA governing deductions will apply. NZ IAS-2 states that the cost of inventories includes the costs of purchase and other production costs. Costs that are directly and indirectly related to production must be included in cost. An example given in NZ IAS-2 of a directly related cost is labour. Indirectly related costs include fixed and variable production overheads. Examples given of fixed production overheads include depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration. Examples of variable production overheads include indirect materials and indirect labour. Consumables used in the manufacture of trading stock must be included in the cost, although consumables on hand do not fall within the definition of trading stock.

NZ IAS-2 is not explicit in addressing the dividing line between costs to be included that relate to bringing inventories to their present location and condition and selling expenses. At paragraph 16, it states that selling expenses are to be excluded from the cost of inventories, as are storage costs, unless those costs are necessary in the production process prior to a further production stage. This may cause an interpretation issue for transport costs incurred once the trading stock is within the control of the taxpayer. However, in practical terms, this aspect of NZ IAS-2 is being interpreted and applied currently. The costs included for financial reporting purposes will be acceptable for tax purposes, provided the financial reports apply NZ IAS-2. Practice may vary slightly between taxpayers and may change over time as accounting systems improve.

**Example 1 (Transport costs not included for financial reporting purposes):**
Company K is a furniture retailer. It has a nationwide chain of stores and a central warehouse. For any particular product, about 50 per cent of the stock will be delivered direct to the stores, with the balance dispatched to the central warehouse. The product from the warehouse is distributed around the country on a replenishment basis to replace stock in the stores as it is sold. Depending on customer requirements, stock may be moved from one store to another, from the store back to the warehouse for supply to another store, or from the warehouse to a store to fill a particular order. Company K has a fleet of its own delivery trucks and employs drivers. For financial reporting purposes, Company K does not include the cost of transport to and from the warehouse and stores in the cost of its inventory. It has never included these costs, and Company K’s auditors regard this as compliance with NZ IAS-2. As a practical matter, it would have great difficulty in identifying the costs which related to delivery of the stock, as the trucks are also used for delivery to customers once a sale has been made. For tax purposes, it is acceptable for Company K not to include the transport costs in the cost of its trading stock.

**Example 2 (Transport costs included for financial reporting purposes):**
Company U is a retailer with many retail outlets nationwide. It has a distribution centre from which all stock orders are coordinated. The deliveries are made from the distribution centre to the outlets for sale to the public. The distribution of stock from the distribution centre to the retail outlets is carried out by a firm which is contracted to Company U for this purpose. For financial reporting purposes, Company U includes the costs paid to the independent contractor for delivery of stock to the retail outlets in its cost of inventory. For tax purposes, Company U would also be required to include these transport costs in the cost of trading stock [see TIB vol 10:12 (December 1998) at 24-25].

Manufacturers or producers using a budgeted or standard cost method of cost allocation must allocate any variances (between the budgeted or standard costs and actual costs of production) between trading stock sold during the year and closing stock. This must be done on a pro rata basis. It is Inland Revenue policy that the apportionment may be made on a global basis and does not need to be further apportioned to raw materials, work in progress and finished goods, or other sub-classifications of trading stock. For operations with multiple activities or products, variances may be allocated according to a fair and reasonable method of apportionment (eg apportioning based on the cost of the stock on hand compared with the cost of goods sold). Other methods of apportionment that are reasonable and appropriate will also be accepted by Inland Revenue for tax purposes.

**Example 3:**
Company B manufactures children’s toys. During the year, Company B made three types of toys: X, Y, and Z. Budgeted production costs were $2,000,000, actual costs incurred were $2,400,000. In other words, Company B had an unfavourable budget variance of $400,000. Company B must pro-rate the budget variance between the cost of sales and the goods on hand at balance date. Company B has decided to pro-rate the variance based on the cost of goods sold compared with the cost of the stock on hand.
### Trading Stock

<table>
<thead>
<tr>
<th>Product</th>
<th>Cost per unit</th>
<th>Units sold</th>
<th>Units on hand</th>
<th>Cost of goods sold</th>
<th>Cost of goods on hand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product X</td>
<td>$7</td>
<td>100,000</td>
<td>35,000</td>
<td>$700,000</td>
<td>$245,000</td>
</tr>
<tr>
<td>Product Y</td>
<td>$8</td>
<td>120,000</td>
<td>22,500</td>
<td>$960,000</td>
<td>$180,000</td>
</tr>
<tr>
<td>Product Z</td>
<td>$12</td>
<td>70,000</td>
<td>17,500</td>
<td>$840,000</td>
<td>$210,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$2,500,000</strong></td>
<td><strong>635,000</strong></td>
<td><strong>635,000</strong></td>
<td><strong>$635,000</strong></td>
<td><strong>$635,000</strong></td>
</tr>
</tbody>
</table>

Allocation proportion = 635,000 ÷ (635,000 + 2,500,000) = 0.2025. Thus 20.25 per cent of the total variance is to be allocated to closing stock. Company B will absorb $81,000 (20.25% × $400,000) of the budget variance into the value of closing stock. The balance of the variance, $319,000, is attributable to goods sold [see TIB vol 10:12 (December 1998) at 26].

FIFO or weighted average cost must be used to assign costs to items of trading stock which are not separately identifiable (eg tubes of toothpaste). Where items of trading stock are separately identifiable (eg works of art) the use of FIFO or weighted average is optional. Other cost flow methods, such as last-in first-out (LIFO), cannot be used under any circumstances. The method of assigning costs when valuing closing stock for tax purposes must be the same as that used in the taxpayer’s financial statements.

High-turnover traders are required to have a valuation of trading stock which is not materially different from that prepared under NZ IAS-2 [s EB 6]. According to Inland Revenue, this means that taxpayers must consider materiality in the context of trading stock alone, instead of in the context of the financial statements as a whole. If materiality was considered in the context of the financial statements, material errors in the valuation of trading stock could be offset by other errors in the financial statements [see TIB vol 10:12 (December 1998) at 24]. The basic principle of materiality, under paragraph 11 of NZ IAS-1: Presentation of Financial Statements, states “omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.”

1. **Valuation of biological assets and agricultural produce [s EB 6(1B)]**

Taxpayers who value their trading stock in accordance with NZ IAS-41 for financial reporting purposes must value their closing stock at cost and include allocated costs so that the value is not materially different from the value obtained by applying NZ IAS-2 (other than paragraph 20).

NZ IAS-41: *Agriculture* is the New Zealand equivalent to International Accounting Standard IAS-41: *Agriculture* and covers the valuation of both biological assets and agricultural produce at the point of harvest. Biological assets include animals, trees and plants. Agricultural produce includes such things as wool, logs, milk, carcasses and fruit. It does not include products that have been processed following harvest such as wine, cheese or processed fruit.

Biological assets are required to be valued at fair value as at each reporting date. However, entities which qualify for differential reporting concessions are permitted to use national average market values or national standard cost [see 430.40 and 430.45] as a proxy for fair value.

Agricultural produce is required to be valued at fair value less estimated point-of-sale costs at the point of harvest. Entities which qualify for differential reporting concessions are permitted to use either fair value or cost. Point-of-sale costs include commissions payable to brokers and dealers, levies payable to regulators and commodity exchanges, transfer taxes and duties. They do not include transport and other costs to get the assets to market.

The requirements for the valuation of biological assets and agricultural produce apply from the earlier of the 2007-2008 income year or the first income year for which the taxpayer adopts IFRS for financial reporting purposes.
Trading Stock

1400.35  **Cost — low-turnover traders** [ss EB 15, EB 16, EB 17, EB 18, EB 22, EB 23]

Low-turnover traders valuing trading stock at cost may either follow NZ IAS-2: Inventories [see 1400.30 for high-turnover traders], or they may use the following simplified method.

Low-turnover traders that manufacture or produce trading stock must include the following costs of production when determining cost:

(a) Direct and indirect materials;
(b) Direct and indirect labour;
(c) Utilities;
(d) Repairs and maintenance to factory plant;
(e) Rent of factory plant.
(f) Depreciation of factory plant.

If a low-turnover trader prepares financial statements that include costs additional to those listed above, the taxpayer must also include those costs in the value of closing stock for tax purposes. This must be done consistently from year to year. Low-turnover traders are not required to allocate any variances between budgeted and actual costs of manufacture to closing stock.

A low-turnover trader that complies with NZ IAS-2 when valuing closing stock at cost must also comply with the consistency and disclosure requirements of NZ IAS-8: Accounting Policies, Changes in Accounting Estimates and Errors. Low-turnover traders that do not comply with GAAP must be consistent from year to year in:

(a) The cost valuation method chosen;
(b) The use of market selling value, if it is greater than cost;
(c) The use of a cost-flow method (FIFO or weighted average);
(d) The extent to which indirect costs are included in the cost of manufacture or production; and
(e) The method of calculating a discounted selling price.

Changes in relation to the above are allowed if it is justified by sound commercial reasons (the advancement, deferral, or reduction of an income tax liability is not a sound commercial reason) or the change is required by another provision of the trading stock regime. A low-turnover trader who makes a change must keep details of the change, and the reasons for it.

Trading stock other than that manufactured or produced by the taxpayer must include the following costs in the value of closing stock:

(a) The purchase price;
(b) Direct transport and insurance costs incurred to bring the trading stock to its present location and condition.

Low-turnover traders must use either FIFO or weighted average cost to assign costs to items of trading stock which are not separately identifiable. They must use the chosen method consistently from year to year.

Taxpayers whose turnover for the income year does not exceed $1,300,000 are permitted to use the value of opening stock as being the value of closing stock, provided that the taxpayer reasonably estimates that the true value of closing stock is less than $10,000.

1400.40  **Discounted selling price** [ss EB 9, EB 19]

(1)  **Retailers — high-turnover traders**

Retailers may value closing stock at discounted selling price (DSP) if they use this method in their financial statements. DSP for each department or category of goods is the total of the retail selling prices of the goods less the normal gross profit margin for the department or category of goods.
“Normal gross profit margin” must be calculated in accordance with NZ IAS-2: Inventories. For example, if stock has been reduced from normal retail price, a corresponding adjustment in the normal gross profit margin will be required. In calculating the normal gross profit margin, taxpayers must include all costs required to be included under ss EB 6 to EB 8 [see 1400.30 and 1400.35]. The normal gross profit margin for each department or category of goods must be recalculated for each income year.

(2) Retailers — low-turnover traders

Low-turnover traders that are retailers may value closing stock at DSP if:
(a) They do not prepare financial statements; or
(b) They prepare financial statements and value that stock using DSP.

The same requirements as for high-turnover traders apply unless annual turnover is $1 million or less (see below).

(3) Retailers — turnover of $1 million or less

Retailers with an annual turnover of $1 million or less may calculate DSP by discounting the total of the retail selling prices of all closing stock by the average gross profit margin for all trading stock that is valued at DSP. This concession means that the overall gross profit margin for the business can be used rather than individual margins for each department or category of goods.

(4) Non-retailers — high-turnover traders

High-turnover traders other than retailers may also use DSP if they use this method in their financial statements. The DSP for each category of goods is the total of the market selling values of the goods in each category less the normal gross profit margin for that category. “Market selling value” is explained in 1400.50. The normal gross profit margin for each category of goods must be recalculated for each income year. In calculating the normal gross profit margin, taxpayers must include all costs required to be included under ss EB 6 to EB 8 [see 1400.30 and 1400.35].

(5) Non-retailers — low-turnover traders

Low-turnover traders that are not retailers may value closing stock at DSP if:
(a) They do not prepare financial statements; or
(b) They prepare financial statements and value that stock using DSP.

The same requirements as for high-turnover traders apply.

(6) Nursery stock

The CIR has issued guidelines for the use of DSP for the valuation of nursery stock [see TIB vol 13:11 (November 2001) at 68], as follows:
(a) Mature plants: The DSP for each category is calculated by multiplying the selling price of the plant by the DSP value. The five categories which fall under this head and the percentage by which the selling price is multiplied are as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bedding plants</td>
<td>58%</td>
</tr>
<tr>
<td>House plants and roses</td>
<td>55%</td>
</tr>
<tr>
<td>Liners/plugs</td>
<td>52%</td>
</tr>
<tr>
<td>Shrubs and perennials</td>
<td>48%</td>
</tr>
<tr>
<td>Trees</td>
<td>42%</td>
</tr>
</tbody>
</table>

Example:
A nursery has 100 mature shrubs on hand at balance date. The shrubs retail at $10 each. The value of the stock for trading stock purposes is $480 (100 plants × $10 × 48%).
(b) **Immature plants**: The DSP of immature plants is calculated by multiplying the DSP of a mature plant by the ratio of the whole years of completed growth to the number of whole years that the plant takes to reach maturity.

**Example:**
A nursery has 100 three-year-old trees and 200 five-year-old trees of a particular variety. The variety of tree takes 10 years to reach maturity at which point they retail for $25. The value of the three-year-old trees for trading-stock purposes is $315 (100 × $25 × 42% × 3/10). The value of the five-year-old trees is $1,050 (200 × $25 × 42% × 5/10).

(c) **Over-mature plants**: The value of plants past their prime or whose value drops is calculated by multiplying their revised market value by the DSP percentage. Where plants are scrapped, their value for trading stock purposes is nil.

Growers are at liberty to calculate their own DSPs but will need to keep records to justify their calculations. Taxpayers not eligible to use the DSP method are required to value their trading stock at cost.

**1400.45 Replacement price** [ss EB 10, EB 20]

(1) **High-turnover traders**
Taxpayers may use replacement price to value closing stock if they use this method in their financial statements. The replacement price of an item of trading stock is the market value (exclusive of GST), for the acquisition of that item on the last day of the income year. If there is no such replacement price (eg seasonal goods), the last price paid for the item by the taxpayer during the income year is taken as the replacement price.

(2) **Low-turnover traders**
Low-turnover traders may value closing stock at replacement price if:
(a) They do not prepare financial statements; or
(b) They prepare financial statements and value that stock using replacement price.

The replacement price of an item, for low-turnover traders, is either the market value of the trading stock on the last day of the income year, or the last price paid by the taxpayer for that item during the income year.

**1400.50 Market selling value — high-turnover traders** [s EB 11]
High-turnover traders may use market selling value to value closing stock only if market selling value is less than cost. In addition, market selling value may only be used if the taxpayer has reasonable evidence to substantiate that value.

Market selling value is the gross amount (exclusive of GST), that the taxpayer normally expects to receive from the sale of an item of trading stock in the ordinary course of business, less the following amounts:
(a) Estimated costs of completion;
(b) Expected selling costs (transport, insurance, sales commissions and sales discounts), if those costs are typically incurred by the taxpayer.

Selling costs can only be deducted by taxpayers that prepare financial statements if those costs have been taken into account in calculating net realisable value in the taxpayer’s financial statements.

Market selling price is the price received in the ordinary course of business. Inland Revenue considers that the meaning of “ordinary course of business” takes into account taxpayers’ business decisions to clear or exit stock lines for a variety of reasons, including seasonal factors and fashion and technology changes. The act of quitting or intending to quit a particular stock line arises as part of the taxpayer’s ordinary course of business. The relevant price at which a taxpayer can clear or exit stock is the market selling value. Sales in the ordinary course of business will also include sales in secondary markets, such as sales of goods that have been traded-in. Therefore sales in the ordinary course of business will include clearance sales when, for example, stock is sold at discount rates. However, the ordinary course of business will not include sales that are not at arm’s length or that are not on an open market (eg as sales made to employees at cheap rates). Market selling value must be calculated on an item-by-item basis. If there are multiple items of stock on hand...
to be valued, the market selling value will be the sum total of the individual items [see TIB vol 10:12 (December 1998) at 28].

There are no special provisions for trading stock which is slow moving or affected by obsolescence. Such stock may be valued at market selling value only if the offering price is less than cost. Taxpayers will not be able to realise (for tax purposes) any loss from holding excess stocks until either the stock has an objective market selling value, or it is sold.

Raw materials and work in progress may be valued at market selling value only if they are to be sold in their unprocessed or unfinished form.

(1) Goods sold into different markets

When the same goods are sold in different markets at different prices, the relevant market selling value will depend on the circumstances. If trading stock for sale into a particular market can be identified or is committed, it should be valued at the relevant value for that market. If the trading stock for sale into a particular market cannot be separately identified, taxpayers should use the following guidelines to make a reasonable estimate of the market selling values for their markets:

(a) Goods available for sale in any one of several markets should be valued at a weighted average price. The weighting should be based on the most appropriate of either the percentage of actual sales or the anticipated sales volume (not taking into account abnormal fluctuations) into each market. The market selling value is the selling price at balance date.

(b) If stock is predominantly available in one market, taxpayers may value all of the stock using the relevant market selling value in that market.

(c) For actual or prospective contracts in foreign currency, taxpayers should use the amount committed, or if it is not yet committed, use the spot rate on balance date [see TIB vol 10:12 (December 1998) at 29-30].

(2) Evidence to support market selling value

A taxpayer must have reasonable evidence to substantiate the market selling value of an item of trading stock. If such evidence is not available, the taxpayer must use a cost valuation method.

According to Inland Revenue, reasonable evidence includes offering prices of goods and actual sales for a reasonable period before and/or after balance date, but before the tax return is prepared. If stock is seasonal and no sales are expected around balance date, the last offering prices for a reasonable period during the year would be acceptable. If either price fluctuations when the market is volatile or exchange rate variations have led to goods being sold for a range of values, the evidence should be the best estimate of market selling value. Taxpayers may have difficulty determining and substantiating market selling value in some circumstances. This may arise when there is no open or active market in the good, or when the stock has not sold for some time, and the taxpayer has reason to believe the goods will not sell at their current offering prices. If this information is not available, and the taxpayer wants to use market selling value, the taxpayer may substantiate the market selling value by a valuation which meets all of the following criteria:

(a) It is carried out by a qualified person (in some circumstances, this person may be employed by the taxpayer);

(b) It is for tax purposes;

(c) It uses the definition of market selling value (and not a net realisable value concept set out in NZ IAS-2); and

(d) It is exclusive of GST.

A proposed sale of large amounts of stock to be held by tender will not substantiate a market selling value if the selling price is not known. The market selling value must have an objective basis [see TIB vol 10:12 (December 1998) at 29].
1400.55 Market selling value — low-turnover traders [s EB 21]

Low-turnover traders may use market selling value whether it results in a value higher than or lower than cost. If market selling value is lower than cost, the valuation must be supported by reasonable evidence. If reasonable evidence is not available, cost must be used. According to the CIR, reasonable evidence for low-turnover traders would be a documented best assessment of market selling value. In this assessment, the taxpayer would be required to document the valuation and state the factors considered in arriving at market selling value, including any recent sales and current offering prices [see TIB vol 10:12 (December 1998) at 32].

If market selling value is higher than cost, the only restriction is that the low-turnover trader must use this method consistently from year to year. Since closing stock is added to gross income, it is unlikely that taxpayers would choose to use a value higher than cost unless there is no practicable alternative.

1400.57 Consumable aids and spare parts [s EA 3]

Consumable aids are excluded from the definition of trading stock for tax purposes and are therefore not covered by the trading stock rules in subpart EB. The term “consumable aids” is not defined for tax purposes, although the comparable term “consumable stores and supplies” is defined in paragraph 4.5 of FRS-4: Accounting for Inventories as aids to manufacture or service, such as fuels and oil, which are absorbed in the production of goods and services for realisation and which do not become part of the finished product or service. Consumable aids are not trading stock because they are consumed or rendered worthless in the manufacturing or production process and do not become an identifiable part of the finished product.

For financial reporting purposes, consumable stores and supplies are included in the cost of inventories [see FRS-4, paragraph 4.1]. If the trading stock valuation figure in the financial statements is to be used for income tax purposes, an adjustment to remove the value of consumable aids is needed.

Although the value of consumable aids on hand at year end is not required to be taken into account under the trading stock rules, if the cost of consumable aids on hand at the end of the taxpayer’s income year exceeds $58,000, it must be added back to income as prepaid expenditure [see 1140 PREPAYMENTS].

Spare parts are also excluded from the definition of trading stock for tax purposes unless they are held for sale or exchange in the ordinary course of business. Spare parts held for meeting warranty requirements will be trading stock because they are held for exchange. Spare parts held for maintaining plant where those spare parts are treated as inventory under FRS-4 should either be depreciated (when appropriate) or be dealt with under the prepaid expenditure rules [see 1140 PREPAYMENTS]. If the trading stock valuation figure from the financial statements (prepared under FRS-4), is to be used for income tax purposes, an adjustment will be required to remove the value of spare parts.

1400.60 Excepted financial arrangements [s ED 1]

An “excepted financial arrangement” is a financial arrangement which is excluded from the application of the financial arrangement rules. It includes shares, options, leases and short term trade credits [see 470.25].

“Revenue account property” is property that falls within any one or more of the following categories:

(a) Property that is trading stock of the person; or

(b) Property that, if disposed of for valuable consideration, would produce income for the person other than income under ss EE 48 (depreciation recoveries), FA 5 (Assets acquired or disposed of after deductions of payments under lease), or FA 9 (Lessee acquiring asset when lease ends); or

(c) Property that is an emissions unit of the person.

It does not include depreciable property.

Excepted financial arrangements which are held as trading stock or are revenue account property must be valued at cost. When more than one of the same type of excepted financial arrangement is held (eg more than one parcel of the same type of shares), the FIFO or weighted average cost methods of assigning costs must be used. Low-turnover traders who do not comply with generally accepted accounting practice must apply the chosen method of assigning costs consistently from year to year and may change between FIFO and
weighted average only if the change is justified by sound commercial reasons. The advancement, deferral or reduction of an income tax liability is not a sound commercial reason. High-turnover traders who do comply with generally accepted accounting practice must comply with the consistency and disclosure requirements of NZ IAS-8: Accounting Policies, Changes in Accounting Estimates and Errors.

Excepted financial arrangements held as trading stock may be valued at nil for tax purposes if they:
(a) Have no current or likely future market value; and
(b) Have been written off by the taxpayer as worthless (eg the shares of companies placed in liquidation, under statutory management, or de-listed from the stock exchange).

1400.65 Insurance receipts [s CG 6]

Insurance, indemnity, compensation, or damages received by a taxpayer for the loss or destruction of, or damage to, any trading stock must be included in the taxpayer’s income if the cost of the trading stock has, in any income year, been allowed as a deduction (other than a depreciation deduction). For these purposes, “trading stock” [see 1400.15] also includes anything produced, manufactured, acquired, or purchased for any purpose ancillary to the business of manufacture or production of goods for sale or exchange.

1400.70 Disposal of trading stock [ss CB 2, EB 24]

Derivation of the income from the sale of trading stock occurs when a legally enforceable debt arises, or the right to be paid otherwise crystallises [see Public ruling BR Pub 04/06 (expired 31 March 2008), TIB vol 16:5 (July 2004) at 17-18].

When trading stock is sold or otherwise disposed of along with other assets of a business (eg on the sale of the whole or a part of a business), the consideration received or receivable by the vendor for the trading stock must be taken into account in determining the vendor’s income for the year. The purchaser is deemed to have acquired the trading stock for the same consideration. This also applies when a share or interest in trading stock is sold or otherwise disposed of [s CB 2] Special rules apply to trading stock transferred to an administrator or executor on the death of a taxpayer and to any subsequent transfer to a beneficiary of the estate [see 1420.197].

The date of sale or disposition differs, depending on whether a clearly expressed intention of the parties exists as to when property in the goods is to pass:
(a) If such an intention is evident from the terms of the contract, the conduct of the parties, and the circumstances of the case, the date of sale or disposition is the date on which the parties intended property in the goods to pass.
(b) If no such intention can be determined, the date of sale or disposition is determined according to the appropriate statutory presumption contained in s 20 of the Sale of Goods Act 1908. In short:
(i) If there is an unconditional contract for goods that are specific and in a deliverable state, it is the date on which the contract becomes unconditional;
(ii) If the vendor must do something to make such goods deliverable, it is the date on which such action is completed, and the buyer is notified;
(iii) If the vendor must weigh, measure, or test such goods in order to ascertain the selling price, it is the date on which such action is completed and the buyer is notified;
(iv) If goods are delivered to a buyer on “sale or return” or similar terms, it is the time at which the buyer signifies approval or retains the goods without notifying rejection within an agreed or reasonable time-frame;
(v) If unascertained or future goods are sold by description, it is when the goods are in a deliverable state and unconditionally appropriated to the contract by either party with the assent of the other.

When trading stock is sold together with other assets of a business, the total consideration must be apportioned on the basis of the assets’ relative values. This consideration apportioned to the trading stock is also deemed to be the price paid for the trading stock by the purchaser. Any trading stock disposed of other than by sale...
or by transfer under a relationship agreement is deemed to have been sold for a consideration equal to its market value at the date of disposal. Similarly, any trading stock sold for a non-cash consideration is deemed to have been sold for a consideration equal to its market value at the date of disposal. These provisions also apply to the sale or other disposition of a share or interest in trading stock sold together with other assets of a business. The section applies whether or not the entire interest in the asset or assets is disposed of or whether the disposal is of a partial interest. It also applies whether or not the disposal is to another person, such as where trading stock is taken by a sole trader for personal consumption.

For the purposes of s FB 4, “trading stock” is defined as:

(a) Anything manufactured or produced;
(b) Anything acquired or purchased for purposes of manufacture, sale, or exchange;
(c) Livestock;
(d) Timber;
(e) Any right to take timber;
(f) Any other real or personal property sold or disposed of where the business of the taxpayer comprises dealing in such property or the property was acquired for the purpose of resale;
(g) Anything for which expenditure is incurred after 31 July 1986 and which, if possession of it were taken, would be trading stock.

Financial arrangements to which the financial arrangement rules apply are excluded from the definition of trading stock for these purposes.

The creation or grant of any right to take timber is treated as a sale or other disposition of trading stock [see item (d) in the above definition].

Where land with standing timber is sold or otherwise disposed of, the sale or other disposition is deemed to include timber as trading stock, except to the extent to which the timber is:

(a) Ornamental or incidental trees;
(b) Subject to a forestry right registered under the Land Transfer Act 1952; or
(c) Subject to a profit à prendre granted before 1 January 1984 [s EB 24].

1400.75 Sale of trading stock for inadequate consideration [ss GC 1, GZ 3]

When trading stock is sold or otherwise disposed of for no consideration, or for a consideration that is less than the market price, the following provisions apply:

(a) The trading stock is deemed to have been sold at market price at the date of sale or disposition.
(b) The price the trading stock is deemed to have realised under (a) is treated as income of the vendor.
(c) The purchaser is deemed to have purchased the trading stock at the price it is deemed to have realised under (a).

“Trading stock” means, for the purposes of s GC 1:

(a) Anything produced or manufactured;
(b) Anything acquired or purchased for the purposes of manufacture or disposal;
(c) Livestock;
(d) Timber;
(e) Any right to take timber;
(f) Any land, if its disposal would produce income under any of ss CB 6 to CB 15 [see 880 LAND SALES]; and
(g) Anything which would be trading stock if possession of it were taken.
Trading stock does not include any financial arrangement to which the financial arrangement rules apply. Neither does it include a share disposed of by a share user to a share supplier, or vice versa, under a share-lending arrangement.

The creation or grant (other than in favour of a proprietor or grantor) of a right to take timber is treated as a sale or other disposition of trading stock.

Where land with standing timber is sold or otherwise disposed of, the sale or other disposition is deemed to include timber as trading stock, except to the extent to which the timber is:

(a) Ornamental or incidental trees;
(b) Subject to a forestry right registered under the Land Transfer Act 1952; or
(c) Subject to a profit a prendre granted before 1 January 1984.

The above provisions also apply to any share or interest in any trading stock (other than land with standing timber that is subject to a timber right) sold or otherwise disposed of for inadequate consideration. They do not apply to:

(a) Trading stock transferred under a relationship agreement;
(b) Trading stock that is donated or supplied to a person for less than market value for use in a farming, agricultural or fishing business that is affected by a self-assessed adverse event, provided that the donor or supplier is not an associated person of the recipient; or
(c) Trading stock that is disposed of in the disposal of an emissions unit under any of the following circumstances:
   (i) Surrender of a unit under the Climate Change Response Act 2002;
   (ii) Transfer of a unit to the Crown under a forest sink covenant; or
   (iii) Transfer of a forest land emissions unit from the person who receives it from the Crown to another person as a party to a forestry rights agreement and as required under the agreement in relation to the allocation of income or emissions units between the two parties.

Section GZ 3 provides an exemption from the operation of s GC 1 where trading stock is donated or sold for below market value in response to the Canterbury earthquakes. For the exemption to apply, the disposal of the trading stock must be to a non-associated person, be for the purpose of relief from the adverse effects of the Canterbury earthquake, and be made in the period 4 September 2010 to 31 March 2012. A provision has also been inserted in the Estate and Gift Duties Act 1968 (s 73B) to ensure that these disposals of trading stock do not constitute a gift.

**1400.80 Transfer of trading stock within wholly-owned group** [ss EB 5, ED 2, CD 28]

(1) **Trading stock [s EB 5]**

Special rules apply where trading stock (other than an excepted financial arrangement) is transferred between companies in a wholly-owned group. Section EB 5 allows the company holding the stock at balance date (“Company B”) to value it at the cost to the group company which originally acquired it (“Company A”). The following conditions must be met:

(a) At all times since the trading stock was originally acquired, it has been held by a company which is a member of the same wholly-owned group and which is resident in New Zealand;
(b) At the end of the income year, both Company A and Company B remain members of the same wholly-owned group; and
(c) Company A and Company B have the same balance date, or have the CIR’s approval to use different balance dates on the basis that this is necessary to prevent the material distortion of net income that would result from gross income and allowable deductions for a single business cycle being reported in different income years.
If Company A and Company B cease to be members of the same wholly-owned group, Company B is deemed to have sold the trading stock for its market value and to have immediately reacquired it at the same price. Any profit or loss arising on the sale of the trading stock is thus realised for tax purposes when the trading stock is transferred out of the wholly-owned group of companies.

If the trading stock has become part of, or has been absorbed into, some other property, and its market value cannot be separately determined, the consideration for the sale is deemed to be the market value of the trading stock when it was acquired by Company B.

(2) **Excepted financial arrangements** [ss ED 2, CD 28]

When an excepted financial arrangement (eg shares) held as trading stock or revenue account property, with a market value of less than cost, is sold or otherwise transferred from one company to another in a wholly-owned group, the transfer is deemed to occur at cost. If the company holding this excepted financial arrangement ceases to be a member of the group, the company is deemed (on the date it leaves the group), to have sold the excepted financial arrangement at market value and then to have immediately reacquired it at the same price. The recognition of any profit or loss on the sale of the excepted financial arrangement is thus deferred until it exits the group of companies. The transfer of the excepted financial arrangement does not trigger the dividend rules. However, this rule applies only to sales, disposals, or distributions of excepted financial arrangements made between New Zealand resident companies. Where excepted financial arrangements enter or leave the New Zealand tax base, the transaction is treated as taking place at market value.

**TaxNote:** These rules do not apply to the transfer of an excepted financial arrangement under a share-lending arrangement.

**1400.85 Trading stock distributed to shareholders** [s FC 1]

When a company distributes trading stock to a shareholder or an associated person of a shareholder, the transfer occurs at market value for both the company and the shareholder.
Chapter 1410
Travelling Expenses

1410.10 Travelling expenses
To be deductible, travelling expenses must be necessarily incurred in carrying on a business for the purpose of deriving gross income for any year.

1410.11 Employee’s travel between home and place of work
A cash allowance paid by an employer to an employee for this purpose is taxable in the employee’s hands as a benefitting allowance. For PAYE purposes the allowance should be added to the employee’s wage or salary and the appropriate tax deduction made from the total. Inland Revenue has power to exempt cash travelling allowances paid to employees to the extent that the allowances reimburse the employees for additional transport costs incurred in travelling between home and work for the benefit or convenience of the employer [see 330.21].

1410.12 Dual purpose journeys
Generally, the cost of travel between the taxpayer’s home and place of work is of a private nature, and not deductible for tax purposes. The present practice for travelling from home to work is as follows:
(a) If a vehicle is used merely to take the taxpayer from home to place of work the expenses are non-deductible;
(b) If, in the course of travel between home and work, the taxpayer engages in an activity which makes a substantial contribution to the business carried on at home, as in the case of a farmer delivering livestock on the journey to work, the vehicle serves a dual purpose, and the tax position would be:
   (i) The cost of getting the taxpayer from home to place of employment is not deductible as being of a private nature; and
   (ii) The cost incurred in gaining the income from the business carried on at the place of residence is deductible.

An apportionment of the expenses should be made in the case of dual purpose expenditure of this kind.

In Case 57 (1977) 21 CTBR (NSW) 639 the taxpayer was a livestock farmer and had a salaried employment away from the farm. He claimed deductions for travelling costs on the grounds that:
(a) He travelled between two places of income derivation;
(b) He frequently carried, in going to and from work, large items such as stock, bales of wool, etc; and
(c) On some occasions he purchased small items for the farm, e.g. nails, on his way home.
The expenses in categories (a) and (c) were disallowed, but category (b) was allowed in full because the business character of the journeys was considerable and the private character incidental. The expenses were claimed against the farming operations, not against the salary.

In TRA Case H50 (1986) 8 NZTC 391 an independent contractor rafting guide paid only for work done on the river could not validly claim deductions for expenses of travelling from his home to the river.

In TRA Case E84 (1985) 5 NZTC 59,645 a taxpayer on two occasions travelled some 200 miles to discuss with his taxation consultant matters relating to provisional tax, penal tax, and overseas tax credits. The TRA disallowed the deduction for expenses on the basis that they were only remotely connected with the calculation of the taxpayer’s income. To be deductible under s DB 3 the expenses would have been principally, if not exclusively, incurred in connection with the calculation of income. In this case it was at best a secondary and remote purpose and then only related to preparatory matters for the calculation.

In TRA Case E87 (1985) 7 NZTC 1,353 a freelance actor was allowed to deduct the cost of travelling from her home in the city to other centres to attend auditions and perform, as the expense of travel to further her employment opportunities was necessarily incurred in carrying on her business for the purpose of gaining income.

In TRA Case H27 (1986) 8 NZTC 264 a retired couple with $130,000 lent on mortgage with loans continually renewed and re-advanced over a lengthy period. They were held to be carrying on a business enabling the deduction of vehicle expenses incurred in meeting prospective borrowers and inspecting properties over which securities were held.

In TRA Case H42 (1986) 8 NZTC 353 a private company was allowed deduction of 50 per cent of running costs for a vehicle but a deduction claim for 50 per cent of repair costs arising from an accident where the principal shareholder was using it for private purposes was disallowed.

In TRA Case L57 (1989) 11 NZTC 1,326 overseas travel and accommodation costs were deductible to a professional artist.

1410.20 Travelling expenses can be capital expenditure in certain cases

Travelling expenses may be of a capital nature, eg when incurred with a view to purchase plant and other fixed capital. Similarly, an overseas trip undertaken to establish new agencies would generally be not deductible. However, where the trip is undertaken by a taxpayer who already has a number of established agencies, mainly to contact existing principals, the claim would be allowed, even if, during the trip, the taxpayer secures further agencies, provided only a moderate extension of the established structure of the business is involved. Where an established business sends its works manager or engineer overseas to make a general survey of new machines, new processes, factory layout etc, the claim is allowed if the trip is not made to buy a specific machine. If it is, the cost of the trip should be capitalised as part of the cost of the machine and depreciation claimed at the appropriate rate.

1410.30 Overseas travel

Trips undertaken to establish new markets or selling agencies, or to grant licences to manufacture overseas, generally qualify as a deduction. Where a company’s business necessitates regular overseas trips, the representatives of the company should contact Inland Revenue and discuss the details, which should be supplied. Generally, where there is an established pattern of travel Inland Revenue is satisfied with the following:

(a) Name(s) of those travelling;
(b) Reason for trip;
(c) Total cost of trip; and
(d) Estimated amount (if any) applicable to holiday and other private purposes.

If the object of the travelling is to acquire stock-in-trade, or to enter into contracts in the ordinary course of business the expenditure incurred is deductible. The cost of bringing employees to New Zealand to establish...
a new business is not deductible but if the employees are brought here to engage in an established business the expenses incurred would, in general be allowed.

The CIR’s policy on the deductibility of foreign travel expenses is set out in TIB vol 7:2 (August 1995) at 13-15.

1410.31 Isolating the private component of travelling expenses

Some entertainment or pleasure may be taken during what is predominantly a business trip, as for instance, when a business trip to Australia coincides with the running of the Melbourne Cup. In these cases, the dominant purpose of the trip determines the deductibility of the expenditure, and where it is clear that the cost of the entertainment was not substantial and does not result in an extension of the time taken for the trip, no adjustment is sought by Inland Revenue. However, where the cost of the entertainment is substantial or the trip has been extended because of personal or entertainment considerations, some adjustment is normally applied.

Conducted tours are sometimes organised by business organisations, wholesalers, retailers, etc to study overseas methods of design, production, selling, and administration. Taxpayers travelling with these organised tour parties may be allowed a proportion of the expenses which Inland Revenue considers relate to the business aspects of the tour. Both local and national groups seeking prior approval of tour and conference deductions should apply to Inland Revenue in the district where the principal organiser of the tour is based.

Inland Revenue considers individual claims when participants furnish their annual returns of income. Each claim is treated on its merits. Only those expenses that are necessarily incurred in deriving gross income are allowable as a deduction. Irrespective of any prior generally approved portion of expenses set as a deduction, any taxpayer may be entitled to more or less than that portion, depending on the circumstances. Participants need to keep receipts and full details of expenditure. On returning to New Zealand, they should maintain the following details:

(a) Name of organisation which arranged the tour;
(b) Itinerary;
(c) Cost of fares, accommodation, and other expenses;
(d) Extent of the holiday or pleasure aspect of the trip; and
(e) Whether the taxpayer was accompanied by spouse [see 960.10] and/or relatives and if so, the total costs relating to the spouse and/or relatives.

1410.32 Accompanying spouse

Generally, the expenses of an accompanying spouse [see 960.10] going overseas are allowed only if one or more of the following factors is present:

(a) The accompanying spouse is employed for a time in the business, is engaged full-time in business activities while overseas, and Inland Revenue is satisfied this person is qualified and competent to carry out the activities allotted to him or her. Consideration would be given to a claim where the accompanying spouse is not a full-time employee of the firm, but the goods handled by the firm are those where the spouse has influence, eg an accompanying wife could provide invaluable judgment for a business dealing in women’s fashions, millinery, jewellery, etc.

(b) Because of the taxpayer’s state of health, it is essential that the spouse is also travelling. A medical certificate is required to substantiate such claims.

(c) Where the travel is connected with an overseas association that expects a spouse to accompany the taxpayer. For example, the husband is employed by a New Zealand concern which is part of, or has direct associations with, an overseas organisation, and it is shown that there is a past pattern that the presence of spouses is expected at overseas conferences etc.

In TRA Case K75 (1988) 10 NZTC 602, travelling expenses incurred for wives accompanying publishing company executives to international and local conferences and seminars were held to be
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1410.32(1)

deductible. The objectives of the wives’ travel were dominantly business and were part of or incidental to the company’s business. Wife support enabled the husbands to carry out their employer’s business. Sufficient nexus existed between the expenditure and the business of the husbands’ employer.

(d) The accompanying person is the spouse of a professional taxpayer (ie medical practitioner, lawyer, engineer etc) and attends an overseas conference with a taxpayer’s spouse who:

(i) Is the leader of the New Zealand delegation to the conference;
(ii) Is required to present a paper at the conference; or
(iii) Is a member who is the only accredited delegate at the conference.

(1) Details required

Where the accompanying spouse’s expenses are claimed, the following details need to be maintained:

(a) The spouse’s qualifications for the work undertaken.
(b) Copies of any correspondence with overseas firms regarding the proposed visit of husband and wife prior to departure.
(c) Copies of resolutions (if any), appointing the accompanying spouse as an official adviser, or to a similar position, for the duration of the trip.
(d) A full itinerary. Details of appointments in each place are required. It is not sufficient to simply state the name of the overseas country or town visited, and the duration of the visit.
(e) Costs of fares, accommodation, and other expenses.

1410.33 Barristers’ and solicitors’ triennial conferences

Actual and reasonable expenses incurred by members of the legal profession in attending the barristers and solicitors triennial conferences are allowed. No deduction for expenses incurred for accompanying spouses [see 960.10] is allowed, except for the spouse of the president of the New Zealand Law Society, and the spouses of those members who present papers. When the president of the society does not attend as the New Zealand leader at an approved overseas conference the expenses of the spouse of the practitioner appointed to deputise for the leader is allowed. Any private or holiday element in the trip is not deductible.

1410.34 Barristers’ and solicitors’ legal conferences overseas

Reasonable travel, accommodation and incidental expenses incurred in attending overseas conferences are deductible only if the member attending is an accredited representative of the New Zealand Law Society. Any deduction should be adjusted for any holiday or private element. Where the dominant purpose of the overseas trip is the attendance at a conference, a greater proportion of the expenses is allowed than if the purpose of the trip is predominantly holiday.

A more liberal attitude is adopted for members attending conferences in Australia. In addition to the accredited representatives of the New Zealand Law Society, it is expected that other members would attend, in which case expenses may be claimed, although the extent to which some adjustment may be necessary for holiday or private expenditure is decided on the same basis as conferences beyond Australia. Those expenses of accompanying spouses [see 960.10] to overseas conferences are not allowed whether to Australia or elsewhere, except in the circumstances outlined above.

1410.40 Establishment of business

Travelling expenses in the nature of establishment expenses are not allowable as a deduction. In B v Commissioner of Taxes (1940) MCD 426 a company commencing business in New Zealand incurred considerable expenses in bringing trained employees from England to form a nucleus staff in New Zealand and claimed to deduct the expenses in the year incurred. It also claimed a deduction for expenses incurred in sending New Zealand employees to England for specialised training. The expenses were disallowed on the grounds that the expenditure was incurred to secure an advantage beyond the year in which the expenditure took place and was therefore expressly precluded as a deduction by the then s 112 [now s DA 2]. The Court
upheld the assessment. However, in the case of an established business, where a taxpayer makes a regular practice of sending employees abroad for training, such expenses are deductible.

**1410.41 Shareholder travelling to annual meeting of company**

In *TRA Case B41* (1976) 2 NZTC 60,341, (1976) 1 TRNZ 642 a shareholder with a substantial holding in an Australian company claimed travelling expenses for trips to Australia to examine the company’s operations and to attend the annual general meeting in an endeavour to persuade the directors to adopt a more generous dividend policy. He claimed to have been instrumental in causing the directors to make a bonus issue but there was no other evidence of a change in the dividend policy of the directors. The objection was disallowed as the taxpayer had failed to show the necessary degree of connection between the expenditure outlaid and the dividend income derived.

In *TRA Case D55* (1980) 4 NZTC 60,830, (1980) 4 TRNZ 148 a director and shareholder in two substantial companies and an investor in other companies in South Africa, the laws of which prohibit the export of capital but not of income. The taxpayer emigrated with his family from South Africa to New Zealand, leaving the management of his investments in South Africa to his accountant there. Becoming disenchanted with the management of his affairs in South Africa, he made several trips back. This resulted in reduced costs and increased income within the company, as the efforts were directed at maximising income at the expense of the capital. The TRA was satisfied that although there was some restructuring of capital assets, the objector’s main purpose in making the first trip was to increase the income which could be sent out to him in New Zealand, and the other trips undertaken were in furtherance of that objective. The expenditure on travel in the relevant years was in the particular circumstances incurred in the course of gaining or producing the objector’s income.
## Chapter 1420

### Trusts and Estates

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1420.10  Trusts and trustees

A trust is a legal relationship between two persons, whereby one of them, the trustee, holds property for the benefit of the other, the beneficiary, while as regards the rest of the world the trustee is, for most purposes, the absolute owner of the property. When beneficiaries get a vested title (as distinct from a contingent title) to the property, they also get a right which is enforceable as a personal right against the trustee.

It is not necessary for a trust to be evidenced in writing. A trust can be made orally or by conduct, and it is a matter of evidence as to when the trust was created. However, most trusts are evidenced by a deed of trust, a will, or other formal instrument. A trust may be *inter vivos* (ie set up by a living person), or it may be testamentary (ie set up through the death of an individual by a will, codicil, Court order, or an intestacy). The date of the creation of an *inter vivos* trust is generally the date of the trust instrument and the date on which a testamentary trust commences is the date of death of the deceased person.

Generally, a trust can only exist when there is a genuine intention upon the part of a person, the settlor [see 1420.65], to put property into a trust for the benefit of definite beneficiaries. Property held by the trustee can generate income, and this imposes an obligation upon the trustee to file income tax returns. For income tax purposes, a “trustee” is defined to also include an executor, an administrator, the Public Trustee, and the Maori Trustee.

Trusts are classified into four categories:

(a) Complying trusts;
(b) Foreign trusts;
(c) Non-complying trusts; or
(d) Charitable trusts.

The income from property held in trust is taxed as either beneficiary income or trustee income. Deductions allowable against the income of a trust are claimable by the trustee, not by the beneficiaries [s DV 9].

1420.15  Complying trusts [s YA 1]

1. Purpose and definition

The purpose of the complying trust definition is to allow both capital gains and income on which the trustees have previously paid tax to be distributed to beneficiaries without further income tax consequences for the beneficiary. The focus of the definition of “complying trust” is on whether income derived by the trustee of a trust has been liable to New Zealand income tax and whether that tax liability has been paid. Accordingly, a complying trust is a trust where all trustee income has been liable to tax in New Zealand for the life of the trust up to the time of distribution. Trustee income must not include an amount that is taxed only as non-resident passive income (ie non-resident withholding tax is a final tax on the income). This applies only to
trusts that have non-resident trustees. In trusts that have non-resident trustees, non-resident passive income should be distributed to beneficiaries in the income year in which it is derived.

The test of whether a trust is a complying trust is applied in any income year in which a distribution is made from the trust. The test is applied to the period starting with the tax year in which a settlement was first made and ending with the tax year in which the distribution is made.

A superannuation fund is automatically a complying trust. Most domestic trusts are complying trusts.

(2) Consequences

If the trust is a complying trust, only beneficiary income is subject to tax in the hands of the beneficiary. Any other distribution from a complying trust is tax-free in the hands of a beneficiary of a complying trust. Beneficiary income includes only revenue amounts that have been received by the trustee and which have not already been taxed in the trustee’s hands at the trustee rate of 33 per cent.

If the trust is not a complying trust it will be a non-complying trust or foreign trust [see 1420.20, 1420.25].

(3) Election by foreign trust

A foreign trust may elect to become a complying trust. The election must be made within 12 months of the day on which the settlor becomes a resident [see 1420.75].

1420.20 Foreign trusts [s YA 1]

A foreign trust is any trust (other than a unit trust) where, at all times from the later of 17 December 1987 or the date the trust was first settled, to the date of distribution in question, no settlor has been resident in New Zealand.

Example:
Jim, a New Zealand resident, is a beneficiary in a trust settled 40 years ago by his Scottish grandmother who never came to New Zealand and who has since died. The trust is a foreign trust for New Zealand tax purposes.

1420.25 Non-complying trusts [s YA 1]

A non-complying trust is any trust other than a complying trust, foreign trust, or a unit trust. Non-complying trusts are those trusts where:

(a) Not all trustees’ obligations for the trustees’ liability to New Zealand income tax have been satisfied;
or

(b) A settlor has been resident in New Zealand after the later of 17 December 1987 and the date the trust was first settled, and no settlor, trustee, or beneficiary has elected to pay tax in New Zealand on trustee income.

It generally has a resident settlor, has been established in a foreign country with non-resident trustees, and has not been liable for New Zealand income tax on trustee income since it was first settled.

1420.30 Charitable trusts [s HC 13]

A charitable trust is any trust in which the trustee income is held in trust solely for charitable purposes, and all income derived by the trustees in the income year is exempt under s CW 41(1) (non-business income of charities) or s CW 42(1) (business income of charities).

In Commissioner of Inland Revenue v Dick (2001) 20 NZTC 17,396 (HC), a trust was found not to be charitable because the trustees were able to (and did) receive benefits from the trust’s business income and to influence the nature and circumstances of the benefits received by virtue of their capacity as settlor and trustee. The decision of the High Court was confirmed by the Court of Appeal in Dick v Commissioner of Inland Revenue (2002) 20 NZTC 17,961 (CA) [see 150.10].

The taxation provisions applying to charitable trusts are as follows:

(a) The settlor has no tax liability [s HC 29];

(b) Trustee income is exempt [ss CW 41, CW 42, see 150.10];
Beneficiary distributions or grants received by a person under the terms of a charitable trust are not liable to income tax.

1420.35 Meaning of distribution [s HC 14]
For the purposes of the trust rules, the term “distribution” has a very wide meaning and occurs whenever the trustees transfer value to a person and the transfer is made because the person is a beneficiary. Such transfers of value could include:
(a) Where any property of the trust has been disposed of or made available to the beneficiary for less than market value. The distribution is the amount by which the value of the property exceeds the consideration paid by the beneficiary;
(b) Where the trustee has provided any services to the beneficiary for less than market value. The distribution is the amount by which the value of the property exceeds the consideration paid by the beneficiary; and
(c) Where the beneficiary has disposed of or made available any property, or provided any service, to the trustee for greater than market value. The distribution is the amount by which the consideration paid by the trustee exceeds the value of the property or services.

The term also includes transfers to other trusts the extent to which it would have constituted beneficiary income if it had been distributed at that time to a New Zealand resident beneficiary. A distribution is made when what is transferred vests absolutely in interest in the person or is paid to the person. A distribution may be made directly or indirectly, or by one or more transactions whether or not those transactions are related or connected. The fact that a person is, or will become, a beneficiary of a trust does not constitute the giving or receiving of value.

1420.40 Trustee income [ss HC 7, HC 24]
The definition of “trustee income” applies to complying trusts but not to a unit trust. It means income which:
(a) Is derived by the trustee in the income year; and
(b) Is not beneficiary income [see 1420.110].
As a consequence of this wide definition, trustee income may include the following amounts, but only to the extent to which they are not beneficiary income.
Income which is:
(a) Accrued to date of death, but received subsequently;
(b) Derived from a financial arrangement under the accrual rules;
(c) Derived pending determination of the distribution of the residue;
(d) Used to pay expenses that are not deductible for taxation purposes (eg rates paid on land not producing income);
(e) Accumulated in terms of the trust;
(f) Used or accumulated to pay debts and legacies (these are required by trust law to be charged to capital);
(g) Held on behalf of un-ascertained beneficiaries;
(h) Of estates assigned for the benefit of creditors.
Also treated as trustee income is the market value property which is settled on the trust and which falls outside of the definition of corpus [see 1420.115].
The provisions for the taxation of beneficiary income and trustee income are mutually exclusive. Therefore, where income is taxed as trustee income, it cannot be assessed as beneficiary income when it is later distributed to the beneficiaries. Similarly, if the trustee withholds income from the beneficiaries pending the settlement of a Court action and it is taxed as trustee income for the year in which it is derived, it cannot be reassessed later as beneficiary income when the Court action is completed.
A trustee is assessable and liable for income tax on trustee income as if the trustee were an individual beneficially entitled to the income except that:

(a) Tax is calculated by reference to the trustee income alone;
(b) There are no entitlements to any tax credits under subparts LC and LD (which relate to tax credits for natural persons and certain gifts). Tax credits such as imputation credits or credits for foreign tax paid are able to be used to satisfy the trustee’s tax liability; and
(c) The trustee may not be a cash basis person under the financial arrangements rules. The one exception to this is the trustee of a deceased estate under certain circumstances [see 470.75].

Trustee income is subject to tax at a flat rate of 33 per cent.

**1420.45 New Zealand-sourced income of trustees**

Income tax is imposed on all New Zealand sourced trustee income.

**1420.50 Foreign-sourced income of resident trustees**  [s HC 26; TAA, ss 22, 59, 59B, 143A]

Trustee income derived from outside New Zealand is exempt from tax in any income year during which no trust settlor is (at any time), a resident in New Zealand. The exemption does not apply where:

(a) The trust is a superannuation fund; or
(b) The trust is a testamentary trust or an inter vivos trust where any settlor of the trust died resident in New Zealand in any income year.

Any income which is beneficiary income is not taxed as trustee income. The exemption is restricted to ensure that sufficient information is supplied to the CIR to enable New Zealand to comply with its DTA obligations regarding the exchange of information. The disclosure rules apply to resident foreign trustees only.

1. **What information is required to be disclosed?**  [TAA, s 59B]

   “Resident foreign trustees” are required to disclose to the CIR the following information:

   (a) The name of the trust or other identifying particulars (eg settlement date);
   (b) The name and contact details of the resident foreign trustees; and
   (c) Whether or not a settlor is resident in the Commonwealth of Australia.

   If the resident trustee claims to be a “qualifying resident trustee”, the name of the “approved organisation” and the name and contact details of the natural person, who is a member of that organisation, must also be disclosed. Where there is more than one resident foreign trustee, one of them may be appointed as agent for the purposes of disclosure. Where this occurs, the names of both the appointing trustee and the appointed trustee must be disclosed.

2. **What do the terms mean?**

   A “resident foreign trustee” is a New Zealand resident trustee of a foreign trust that is not registered as a charitable entity under the Charities Act 2005.

   A “qualifying resident trustee” is a resident foreign trustee who, if an individual, is a member of an “approved organisation” and, if not an individual, has a director or person in a management position who is resident in New Zealand and is a member of an “approved organisation”.

   An “approved organisation” is an organisation approved by the CIR. Criteria for approval includes the existence of a professional code of conduct and a disciplinary process to enforce compliance with the code. Members of the organisation will typically provide trustee services in the course of business. Other criteria include whether members are required to have certain qualifications and the size of the organisation’s membership. Names of approved organisations are published on Inland Revenue’s website.
(3) **What records need to be kept?**
Resident foreign trustees are required to maintain certain financial and other records for a period of seven years [see 1210.10, 1210.20].

(4) **What are the penalties for non-disclosure or failing to maintain records?**
Failing to comply with the rules when the resident trustee knew or should have known what was required is a knowledge offence under s 143A punishable by a monetary fine and/or imprisonment. If the trustee is a corporate entity, directors and managerial staff whose actions or failure to act gave rise to the offence are also subject to penalties [see 1110.230, 1110.265].

If a trustee who is not a “qualifying resident foreign trustee”, has been requested to provide information, and has failed to supply that information, the s HC 26 exemption does not apply and the trust is subject to New Zealand tax on its world-wide income.

(5) **Newly-resident trustees**
Section 59B(3) of the TAA provides a period of grace for newly-resident trustees of foreign trusts. In order for the concession to apply, the person must:

(a) Have been appointed trustee prior to becoming a New Zealand resident;
(b) Have become New Zealand resident on or after 1 October 2006;
(c) Not be in the business of providing trustee services; and
(d) Have been not resident in New Zealand on any day in the five-year period prior to becoming New Zealand resident.

Following the expiry of the two-year period of grace, the trustee must commence complying with record-keeping and information disclosure requirements.

**1420.55 Foreign-sourced income of non-resident trustees** [s HC 25]
A non-resident trustee is subject to tax on any foreign-sourced income that would be taxable to a New Zealand resident where:

(a) Any settlor of the trust is resident in New Zealand, but not a transitional resident, at any time during the income year;
(b) The trust is a superannuation fund; or
(c) Any trustee is resident in New Zealand during the income year and the trust is a testamentary trust or an inter vivos trust where any settlor died resident in New Zealand in any income year.

However, s HC 25(3) provides that a trustee who is non-resident for the whole of the income year will not be subject to New Zealand tax on foreign-sourced income where:

(a) No settlement has been made on the trust after 17 December 1987; or
(b) The only settlements made on the trust were made by settlors who were not at the time of making the settlement, and had not at any time after 17 December 1987 been, resident in New Zealand; and, in both instances, where no election has been made by the trustee to pay income tax on trustee income.

Even though an exclusion might apply to income tax on trustee income, it does not affect the liability for income tax of any settlor personally. A settlor who is resident in New Zealand can (in certain circumstances), be made liable as agent for income tax on trustee income. A trustee is both assessable and liable for income tax on the distribution of beneficiary income and taxable distributions.

Non-resident trustees are treated as being resident in New Zealand for the purposes of:

(a) The application of the financial arrangement rules in ss EW 9 and EW 11 [see 470 FINANCIAL ARRANGEMENTS];
(b) The availability of tax credits for foreign tax paid [s LJ 2, see 760 INCOME FROM NEW ZEALAND AND FOREIGN SOURCES];
Rules for the operation of BETA accounts [see 670 IMPUTATION]; and
The international tax rules [see 850 INTERNATIONAL TAX REGIME].

**TaxNote:** Section HC 25 does not apply for the purpose of determining whether or not the trust is a complying trust.

### 1420.60 Liability of trustees for tax on distributions to minors

**[ss HC 3, HC 7, HC 17, HC 35, HC 36, HC 37, HD 12(1)]**

Trusts have always been a useful tool where a taxpayer wishes to divert income to family members whose marginal tax rates are lower than the taxpayer’s. However, provisions aimed at limiting this practice apply to the beneficiary income of minors.

Where more than one settlement is made on a trust, the general legal position is that each settlement constitutes a separate trust. However, s HC 3 provides that, for the purposes of subpart HC, all of the settlements may be treated as being one trust.

Subject to the exemptions (explained below), any beneficiary income distributed to a minor is subject to tax in the hands of the trustees of the trust and is not included in the income of the beneficiary [s HC 35]. Any tax paid by the trustee on this income is deemed to be paid on behalf of the beneficiary for the purposes of debiting and crediting the beneficiary’s account in the books of the trust [see TES 20 (October 2004) 275, 276].

1. **Exemptions — small distributions [HC 35(4)]**

   This provides that the rules do not apply if the amount of beneficiary income derived by a minor in relation to an income year is $1,000 or less. The $1,000 limit applies on a “per beneficiary, per trust” basis. Therefore, if a beneficiary receives $1,000 or less from each of a number of trusts, none of the distributions will be subject to the rules [see TIB vol 19:4 (May 2007) at 10].

2. **Exemptions — type of trust [HC 35(4)]**

   The rules do not apply to beneficiary income derived:

   (a) From a trust where:

      (i) The settlor is acting as agent of the minor and has received the property from a person other than a relative, guardian, or their associate;

      (ii) The settlor is required by a court order to pay damages or compensation to the minor; or

      (iii) the minor is a protected person, as defined in s 2 of the Domestic Violence Act 1995, in relation to a protection order, and the settlement is made before the protection order is made or during the time the order is in force;

   (b) From a testamentary trust where all of the settlements were made under a will, codicil, intestacy, or court variation and either:

      (i) The minor is alive within 12 months of the date of the settlor’s death; or

      (ii) The minor has a brother, sister, half-brother, or half-sister alive within 12 months of the date of the settlor’s death;

   (c) From a Maori authority;

   (d) Directly from a group investment fund; or

   (e) By a person for whom a child disability allowance is paid under the Social Security Act 1964.

3. **Exemptions — Source of settlements [ss HC 36(1), HC 37]**

   The rules do not apply where all settlements on the trust are made:

   (a) By a person who is neither a relative or legal guardian of the minor nor a person associated with the relative or legal guardian;
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(b) By a relative, legal guardian, or associated person as an agent of the minor if the settlor has received the property from someone other than a relative, guardian or associated person;

(c) By a relative, legal guardian or associated person if the settlor is required by a Court order to pay damages or compensation to the minor;

(d) By a relative, legal guardian or associated person against whom a protection order has been made under s 14 of the Domestic Violence Act 1995. This provision applies only where the minor is a protected person in relation to the protection order and the settlement is made either before or during the time that the protection order is in force; or

(e) According to a will, codicil, intestacy or a Court variation of a will, codicil or intestacy, if the minor, or a brother, sister, half-brother or half-sister of the minor, is alive within 12 months following the date of the settlor’s death.

Where there is more than one settlement on a trust and one or more of those settlements is not exempt under items (a) to (e) above, this exemption continues to apply where all of the settlements that would not be exempt are either:

(a) Dispositions of property to the trust at less than market value, where those settlements have a total value of not more than $5,000 at the end of the trust’s income year, with valuation being as at the date of settlement; or

(b) The making of loans to the trust for less than the market interest rate where those loans have a total value of not more than $1,000 on any day in the trust’s income year.

However, there is a requirement that at least one of the settlements is of a kind referred to in items (a) to (e) above.

This exemption does not apply where services (other than those that are incidental to the operation of the trust such as bookkeeping or the duties of a trustee), are provided to the trust by a relative or legal guardian of a minor beneficiary (or associated person of a relative or legal guardian of a minor beneficiary). Therefore, the exemption will not apply to trading trusts carrying on business in a service industry (such as a medical practice) where a person (such as a relative of the minor beneficiary) has sold the assets of the business to the trust and continues to operate the business in return for a salary, with the trust deriving the profits.

(4) Exemption — disabled children [s HC 35(4)(b)(v)]

An exemption is provided in respect of beneficiary income derived by a minor for whom a child disability allowance is paid under the Social Security Act 1964.

(5) Definitions [ss HC 36, HC 35(3)]

The definitions of “minor”, “guardian”, and “relative” are crucial to the scope and application of these rules.

“Minor” means a natural person who is New Zealand resident and who is under 16 years of age at the trust balance date for the income year in which the distributed income was derived.

“Guardian” is defined under s 15 of the Care of Children Act 2004, but does not include a guardian appointed under certain sections of the Children, Young Persons and Their Families Act 1989, s 31 of the Care of Children Act 2004, s 53 of the Public Trust Office Act 1957 (by way of Court order), or s 7(4) of the Adoption Act 1955.

“Relative”, in relation to a person (“Person A”), means a person (“Person B”) connected with Person A by blood relationship within the fourth degree, marriage, adoption, or guardianship, and includes a trustee of a trust under which Person B has benefited or is eligible to benefit.

Blood relationship applies if it is within the fourth degree of relationship.

Marriage applies if one person is in a marriage, civil union or de facto relationship with the other or with a person who is connected by blood relationship, adoption or guardianship to the other.

Adoption applies if one has been adopted as a child of the other or as a child of a person who is within the third degree of relationship to the other.
Guardianship applies if one is the guardian of the other.

**1420.65 Meaning of settlor** [s HC 27]

“Settlor” has a wide definition. It means a person who, at any time, transfers value to, or for the benefit of, the trust, or on terms of the trust. This includes the provision of financial assistance where there is an obligation to pay on demand but the right to demand is not exercised or is deferred. The same meaning is assigned to the term “settlement”. It makes no difference whether the transfer of value is made directly or indirectly or whether it is made in one or more than one transaction.

The fact that a person is, or will become, a beneficiary of a trust does not constitute the giving or receiving of value.

The definition is expanded in s HC 28 for the purposes of the trust rules. If a person undertakes any of the following activities, the person will be a settlor in relation to a trust:

(a) The person acts or refrains from acting, or enters into one or more transactions, and this results in defeating the intent and application of the trust rules;
(b) The person has a control interest of 10 per cent or more in a controlled foreign company (CFC) [see 850.10] and the CFC settles an amount on a trust;
(c) A company settles an amount on a trust and, had the company been a foreign company, it would have been a CFC on the date of settlement and the person would have been treated as having a control interest of 10 percent or more;
(d) A trustee of a head trust settles an amount on a sub-trust, or makes a distribution to, or on terms of, the sub-trust and the person is a settlor of the head trust;
(e) The person directly or indirectly acquires rights or powers in relation to a trustee or settlor of the trust with the purpose or effect of being able to require the trustee to treat the person (or a nominee of the person) as a beneficiary of the trust.

(1) **Exclusions from the definition of “settlor”**

There are a number of exclusions from the definition of “settlor”. These are:

(a) **Trusts for retirement benefits for employees**

The term “settlor” does not include a person who is resident in New Zealand and who makes a settlement on a trust for the benefit of one or more of the person’s employees, provided that the following conditions are met:

(a) The trust is established or created mainly to provide retirement benefits to natural persons; and
(b) The trust is neither a foreign superannuation scheme nor a superannuation fund.

(b) **Employee share purchase agreements**

The term “settlor” does not include an employer in relation to a payment made by that person to the trustee of an employee share purchase agreement, where the following conditions are met:

(a) Some or all of the payment is used by the trustee to acquire shares under the terms of the employee share purchase agreement; and
(b) Some or all of the payment used by the trustees would be income of an employee under s CE 1(1)(d), which deems a benefit received under a share purchase agreement to be an amount derived in connection with employment.

This exclusion applies for the 2008-2009 and later income years. However, it is grand-parented so that it does not apply to a tax position taken between the beginning of the 2008-2009 income year and 7 December 2009 (inclusive) in relation to a payment to an employee share purchase agreement in consideration for a salary sacrifice made by the employee in reliance on para (a)(i) of the definition of “settlor” in the ITA 2004.
(2) Binding rulings

Section HZ 7 provides a savings mechanism for binding rulings in relation to the definition of settlor where certain conditions are met.

1420.70 Taxation of settlors [ss HD 12(2), HC 29, HC 10(4)]

A New Zealand resident settlor of any foreign or non-complying trust can be liable for tax in New Zealand on trustee income as agent of the trustee.

The settlor regime applies for any trust and any income year in which the trustee derives trustee income and a settlement is made to the trust after 17 December 1987, except in any of the following circumstances:

(a) The trust is a charitable trust;
(b) The trust has a resident trustee at all times during the income year;
(c) The settlement is to a superannuation fund;
(d) The settlor was not a resident in New Zealand at the time of any settlement on the trust and has not at any time, unless the settlor has elected to pay income tax on trustee income;
(e) To the extent to which the settlor can satisfy the CIR that the settlor’s liability for income tax on trustee income exceeds the liability that the settlor should bear by comparison to other settlors having regard to their respective settlements; or
(f) The trustee income is derived through the application of the financial arrangements rules to any amount remitted by the settlor.

1420.75 Trusts settled by persons before becoming New Zealand resident [ss HC 30, HC 10]

Any settlor, trustee, or beneficiary of a foreign trust may, within 12 months of the day on which the settlor becomes a resident, elect to pay income tax on the trustee income. The foreign trust thereby becomes a complying trust. Where this is done, for the purposes of the definition of “taxable distribution” the trust is deemed to be:

(a) A foreign trust to the extent that any distribution consists of income, capital profits, and capital gains derived by the trustee before the date on which the election was made.
(b) A complying trust to the extent that any distributions consist of income, capital profits, and capital gains derived by the trustees after the date on which the election was made if the trustees’ income tax liability on trustee income has been satisfied. However, if in that year or any subsequent year, the trustees’ obligations are not satisfied, the trust is deemed to be a non-complying trust for distributions made, except for distributions which are deemed to be from a foreign trust relating back to the date before the date on which the election was made.

Where this election is not made, for the purposes of the definition of “taxable distribution” the trust is deemed to be:

(a) A foreign trust to the extent to which any distribution consists of income capital profits and capital gains derived by trustees before the election expiry date (ie 12 months from when the settlor first became resident in New Zealand).
(b) A non-complying trust to the extent to which any distribution consists of income, capital profits, and capital gains derived by the trustees after election expiry date.

The income, capital profits, and capital gains apportioned to either part of the income year is proportionally allocated on a day-to-day basis.

Where the settlor of the trust is a transitional resident, the 12-month period in which to elect that the trust become a complying trust runs from the date on which the settlor ceases to be a transitional resident. During this period, the trustee is not subject to New Zealand tax on foreign income of the trust [see 370.35].
1420.80 Ordering rules for distributions from foreign and non-complying trusts

Ordering rules determine the nature of a distribution from any trust and remove the ability for foreign and non-complying trusts to make non-taxable distributions to New Zealand resident beneficiaries.

Distributions made from a trust are in order of priority:

(a) Trustee income derived in the current income year;
(b) Distributions of accumulated trustee income from preceding income years;
(c) Capital profits realised during the current income year less any current year capital loss;
(d) Capital profits or gains from all preceding income years less any prior year capital losses; and
(e) Trust corpus [see 1420.115].

Where accounting records are not sufficient to enable any distribution to be ordered, the entire distribution is deemed to be a taxable distribution. These ordering rules do not apply to:

(a) Distributions from complying trusts (unless the trust was first settled before 18 December 1987 and an election was made before 1 June 1989 to pay tax on trustee income);
(b) Distributions from a testamentary trust or a non-discretionary trust on which no settlement has been made after 17 December 1987;
(c) Deemed distributions which have only fallen within the definition of “distribution” because they involve either the disposition of property or the provision of services to a beneficiary for less than market value; and
(d) Distributions from foreign trusts which become complying trusts.

A distribution specified in items (a), (b), or (d) above, is deemed to consist of such amounts as reflect the terms of the trust or the terms of the exercise of the trustee’s discretion. A distribution specified in (c) is a taxable distribution.

Two anti-avoidance provisions exist:

(a) If the trust records are inadequate to allow the rules to be applied accurately in calculating the component parts of a distribution, the distribution becomes a “taxable distribution”.
(b) In calculating the component parts of a distribution, it must be shown that the amounts distributed to other beneficiaries arose from a genuine transaction which is entered into and carried out in good faith and which places the amount beyond the trustee’s possession.

1420.85 Nature of trust income

Income earned by a trust retains its nature on distribution to beneficiaries. This means that:

(a) Capital gains remain capital gains when distributed to beneficiaries.
(b) Distributions of dividends derived by a trust retain their nature as dividends and can have imputation credits distributed with them.
(c) Income that has a foreign source retains that foreign source and is not, therefore, taxable in the hands of a non-resident beneficiary on distribution.

TaxNote: Beneficiary income derived by a minor is excluded income and is taxed as trustee income.

1420.90 Taxation of beneficiaries in a complying trust [ss HC 17, HC 20, CW 53, CV 13]

Beneficiaries of a complying trust are taxable only on beneficiary income [see 1420.110] distributed to them. Any other distribution from a complying trust is exempt income in the hands of a beneficiary of a complying trust. For example:

(a) Income taxed in the hands of the trustees in prior income years;
(b) Capital gains;
(c) The corpus of the trust [see 1420.115].

**1420.95 Taxation of beneficiaries in a foreign trust** [ss HC 15, HC 17, HC 18, CV 13]

Beneficiaries of a foreign trust are taxed on two types of income:
(a) Beneficiary income;
(b) Taxable distributions.

For the purposes of a foreign trust, the term “taxable distribution” is defined in s HC 15 as any amount distributed to a beneficiary that is not:
(a) Beneficiary income;
(b) A capital gain; or
(c) Trust corpus [see 1420.115].

Any current year income distributed to a beneficiary falls within the definition of “beneficiary income”. Distributions of capital gains and corpus are excluded from the definition of “taxable distribution”. Therefore the most common item that remains to fall within the latter definition is distributions of income earned in prior years. However, income earned by the trust prior to 1 April 1988 is not caught by the regime and does not fall within the definition of “taxable distribution”.

TaxNote: Included in the definition of “taxable distribution” are items that may at first sight appear to be corpus or a capital gain, but which actually fall outside of those definitions.

A capital gain, in the definition of “taxable distribution”, is a realised capital gain not derived from a transaction or series of transactions between a trustee and any person associated with a trustee, net of any capital loss incurred in the same income year.

**1420.100 Taxation of beneficiaries in a non-complying trust** [ss HC 15, HC 17, HC 19, CV 13, CX 59]

Amounts distributed to a beneficiary of a non-complying trust are taxed as follows:
(a) **Beneficiary income**: at the beneficiary’s marginal tax rate
(b) **Taxable distributions**: at 45 per cent.

For the purposes of a non-complying trust, the term “taxable distribution” means any distribution that is neither beneficiary income nor corpus [see 1420.115]. Therefore beneficiaries are taxed at the rate of 45 percent on any distribution of income earned by the trust in prior income years and on any capital gain. The one exception is that trust income prior to 1 April 1988 is not caught by the regime.

**1420.105 Summary of the taxation of beneficiaries**

The following table summarises the different tax treatments applying to beneficiaries of qualifying, foreign, and non-complying trusts.

<table>
<thead>
<tr>
<th>Distribution</th>
<th>complying trust</th>
<th>Foreign trust</th>
<th>Non-complying trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trustee income</td>
<td>33%</td>
<td>33%</td>
<td>33%</td>
</tr>
<tr>
<td>Beneficiary income</td>
<td>Beneficiary’s marginal tax rate</td>
<td>Beneficiary’s marginal tax rate</td>
<td>Beneficiary’s marginal tax rate</td>
</tr>
<tr>
<td>Pre-1 April 1988 accumulated funds</td>
<td>Non-taxable</td>
<td>Non-taxable</td>
<td>Non-taxable</td>
</tr>
<tr>
<td>Post-1 April 1988 accumulated funds</td>
<td>Non-taxable</td>
<td>Beneficiary’s marginal tax rate</td>
<td>45%</td>
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</tbody>
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**Distribution**

<table>
<thead>
<tr>
<th></th>
<th>complying trust</th>
<th>Foreign trust</th>
<th>Non-complying trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital gains arm’s-length</td>
<td>Non-taxable</td>
<td>Non-taxable</td>
<td>45%</td>
</tr>
<tr>
<td>Capital gains non-arm’s-length</td>
<td>Non-taxable</td>
<td>Beneficiary’s marginal tax rate</td>
<td>45%</td>
</tr>
<tr>
<td>Corpus</td>
<td>Non-taxable</td>
<td>Non-taxable</td>
<td>Non-taxable</td>
</tr>
</tbody>
</table>

**TaxNote:** Beneficiary income of minors is (under some circumstances), taxable in the hands of the trustee at 33 per cent [see 1420.60].

**1420.110 Meaning of beneficiary income** [s HC 6]

“Beneficiary income” means any income derived during any income year by a trustee of a trust which:

(a) Vests absolutely in interest in the beneficiary during that income year; or

(b) Is paid to the beneficiary in the longer of the following periods:

(i) During, or within six months after the end of that income year;

(ii) By the date on which the trust’s tax return for the income year is filed (or is required to be filed, if earlier).

**TaxNote:** “Paid” includes distributed, credited and dealt with in the interest of or on behalf of the person in some other way [s YA 1].

Beneficiary income includes foreign-sourced amounts which have vested or been paid or applied where that amount would have been income of the trustee had any settlor been resident in New Zealand during the income year [see TES 20 (October 2004) 277, 279].

It does not include income derived by a trust which is a superannuation fund. This is because the taxation of superannuation funds is intended to result in a non-taxable distribution under the “Taxed-Taxed-Exempt” (TTE) policy which underlies the legislation. This results in both the employer’s contributions to the fund and the fund’s taxable income being fully taxed as a proxy for taxing the beneficiaries’ interests in the fund. A distribution is not income of the beneficiary under s HC 20 because a distribution from a superannuation fund cannot be beneficiary income.

Section HC 20 is subject to s HC 21, which applies to distributions from community trusts. Section HC 21 is effective from the 2004-2005 income year and provides that, despite the provisions of ss HC 15 and HC 20, the distribution is income of the recipient in the year of receipt to the extent to which the distribution does not represent:

(a) Trustee income derived in or before the 2003-2004 income year;

(b) Corpus of the trust;

(c) Capital gains derived by the trust; or

(d) A distribution, settlement or dividend made to the community trust in the 2004-2005 or 2005-2006 income year, where the community trust provided the corpus of the trust to be used for charitable purposes, or the company is wholly-owned by the community trust and maintained and carried on exclusively for charitable purposes. In both cases, the fact of the distribution, settlement, or dividend, is ignored in determining whether the charitable purpose test is met.

The provisions applicable to beneficiary income do not apply to unit trusts. Unit trusts are deemed to be companies, and the unit holders are deemed to be shareholders. Nor do they apply to management fees paid by a group investment fund to a trustee company on behalf of, or as agent for, its investors.

Where the trust instrument directs that a beneficiary is to have the use and occupation for life of a property free of outgoings, the income assessable to that beneficiary as beneficiary income includes any outgoings on the property paid by the trustees for the benefit of the life tenant (ie any outgoings which the life tenant would otherwise be liable to pay, such as rates).
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Example:
An estate is held on trust to pay the income for life to the deceased’s widow, and she is to have for life the free use of the deceased’s home and the income from the interest. The net income available to the widow is $20,000, and the trustees pay $400 in rates on the widow’s free house. The beneficiary income for the widow is therefore $20,400.

If any income is paid to a beneficiary subject to an obligation or trust to maintain another person, whether out of that income or otherwise, the beneficiary is assessable as if the income were derived free of any such obligation.

Income of a trust which is vested absolutely in interest for the benefit of any beneficiary (whether adult or infant) during the income year is deemed to be beneficiary income. Vesting can arise under the express provisions (if any) of the trust instrument or the discretionary powers (if any) conferred on the trustees by the trust instrument.

An anti-avoidance provision exists to counter arrangements whereby property is transferred, or services or other benefits are provided, by a trustee to a person other than a beneficiary which has the effect for that beneficiary of defeating the intent and application of ss HC 17 to HC 23 (income assessable to beneficiaries). The property, services, or other benefits are deemed to be received or enjoyed by the beneficiary [s GB 22]. This provision does not apply where the trust is a Maori authority.

(1) Case law

Once income has vested in beneficiaries and they are entitled to its distribution, they are entitled to possession of that income: Dalyrymple v Commissioner of Taxes [1934] NZLR 366 (CA). It is possible for income to be vested in beneficiaries without it being in their possession.

In Simpson v Commissioner of Inland Revenue (1987) 9 NZTC 6,147 (HC), the trustees resolved to appropriate the whole trust income to two infant children. The trust deed provided a good and valid discharge to the trustees if payment was made to their parents and guardians. The income was paid to the parents’ joint account. The High Court held that the good and valid discharge to the trustees meant the infants had taken an indefeasibly vested interest in the trust income which was thus income of the infant beneficiaries. This was upheld on appeal: Commissioner of Inland Revenue v Simpson (1989) 11 NZTC 6,140 (CA). Note this case related to law under the earlier tax regime.

An application of funds whereby the beneficiary’s position is improved (eg by settling funds on another trust for the same beneficiaries) is a payment or application of income: Re Pilkington’s Will Trusts [1964] AC 612 (HL).

Income which is applied in a beneficiary’s favour, at the time of the trustee’s resolution, is beneficiary income even though it is not immediately used by the beneficiary: Commissioner of Inland Revenue v Ward [1970] NZLR 1 (CA).

An agreement between waterside unions and container terminal companies, whereby equity payments were paid by the companies to a trustee, was income received by the trustees as nominees or agents for the union beneficiaries, and accordingly was derived by the unions and not the trustees: TRA Case K70 (1988) 10 NZTC 562.

Trustees were given a discretionary power by the trust deed to apply the trust income for the personal support and benefit of the beneficiary. However, the deed provided that any unpaid or unapplied income by 31 March in any year was to vest in the beneficiary provided she was alive on that date. During the income year none of the income was paid or applied for the benefit of the beneficiary, and it fell to be taxed as trustee income. However, the trustees claimed that the tax on the trustee income was an application of that part of the trustee income for the benefit of the beneficiary, since the unapplied income vested in the beneficiary on that date. The TRA decided that the payment of the tax on the trustee income was not a payment for the benefit of the beneficiary but rather it was to discharge a liability of the trustees. In any case, it could not be the beneficiary’s income because it could not be known that she had survived 31 March until the next day, 1 April. Consequently, on 31 March she was only contingently entitled to the unpaid or unapplied income: TRA Case C28 (1978) 3 NZTC 60,270.
Legal costs which the trustees paid out of the trust income to reimburse the settlor for the setting up of the trust were not a payment for the benefit of the beneficiaries under the Land and Income Tax Act 1954, and the income represented by the payment was assessable as trustee income: TRA Case C29 (1978) 3 NZTC 60,276.

1420.115 Meaning of corpus [s HC 4]

“Corpus” means the market value at the date of settlement of any property settled on the trust. It does not include property which:

(a) Would have constituted beneficiary income or a taxable distribution for a New Zealand resident beneficiary of another trust, which is settled directly or indirectly by the trustee of the other trust.

(b) Is settled directly or indirectly in trust which would otherwise, but for that disposition, have constituted income of a New Zealand resident settlor.

(c) Is settled directly or indirectly in trust and which the settlor is able to claim as a deduction in calculating the income for income tax purposes.

1420.120 Changes in residence for beneficiaries in foreign or non-complying trusts [ss CV 15, HC 23]

A New Zealand resident beneficiary of a foreign trust or a non-complying trust who ceases to be a resident, but within a period of five years becomes a New Zealand resident again, is deemed to derive, on the day of again becoming a New Zealand resident, any amount that would have been assessable as beneficiary income or a taxable distribution had he or she remained resident in New Zealand.

1420.125 Trust loss or expenditure cannot be passed to beneficiary [s DV 9]

A person who has beneficiary income is not allowed a deduction for any expenditure or loss incurred by a trustee in deriving that income. The net income of a trust may be allocated as beneficiary income. Only the net income is the amount derived after the trustee has claimed a deduction for any related expenditure or loss. If the expenditure or loss in a trust exceeds the income of the trust, a net loss arises and that net loss cannot be allocated to a beneficiary. It must be carried forward within the trust and is deductible, under the normal provisions, from future income of the trust.

Example:

| Income of the trust | $10,000 |
| Allowable expenditure | $12,000 |
| Loss to be carried forward to next year | $2,000 |

The loss of $2,000 cannot be allocated to a beneficiary and there is no net income that can be allocated to a beneficiary.

1420.130 Imputation and dividend withholding payment credits on beneficiary or trustee income

Dividend income derived in a discretionary trust is able to be allocated in such proportions as the trustees determine. In a fixed trust, the distribution is determined by the terms of the trust deed. However, tax credits in the form of imputation credits and dividend withholding payment credits are allocated proportionately across all amounts distributed to beneficiaries in that income year. This includes all distributions whether income or capital in nature. This restricts a trust being used to stream dividends with their associated tax credits in a tax cost effective way (eg away from exempt or low tax rate shareholders), to bypass the anti-avoidance provisions in the company income tax regime [see 670.55].
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1420.132  **Substitution payments for resident withholding tax**

Trustees in receipt of resident passive income from which resident withholding tax (RWT) has been deducted, have the option of passing credits through to beneficiaries when distributing that income or effectively retaining the credits to be offset against tax payable on trustee income. Where the credits are retained in the trust, the trustees are able to make an RWT substitution payment to the beneficiary concerned to compensate for the loss of the credit. The payment can be the amount of the RWT credit or a lesser amount. An RWT substitution payment is treated as resident passive income in the hands of the beneficiary but is not, itself, subject to deduction of RWT. The substitution payment does not give rise to a credit in the hands of the beneficiary but the trustees have a credit equal to the amount of the payment.

1420.135  **Foreign tax credits on beneficiary or trustee income**

A foreign tax credit is allowed for foreign tax paid on trustee or beneficiary income, but limited to the lesser of either the foreign tax paid or the New Zealand tax payable on that income. Foreign tax credits are allowed for foreign taxes paid on taxable distributions but are limited to the equivalent of the foreign NRWT [see 760.40 and 760.45].

1420.140  **Non-resident beneficiaries**

A non-resident beneficiary is only liable for tax on income deemed to be derived in New Zealand. Beneficiary income of non-resident beneficiaries in a trust which has come from foreign sources is not assessable for New Zealand income tax or NRWT. However, income which is derived in New Zealand for non-resident beneficiaries is subject to either NRWT or income tax, as the case may be. Normally, the person or company paying the non-resident passive income is required to deduct the NRWT, but when interest, dividends, royalties, or know-how payments are made to New Zealand trustees for non-resident beneficiaries, this responsibility depends on the terms of trust.

1420.145  **NRWT where all trust income is received for foreign beneficiaries**

When the trustees are bare trustees [see 1420.190] and all of the income apart from commission or collection costs is passed on to the foreign beneficiaries, the original payer must deduct NRWT. In some cases, Inland Revenue allows the trustees to deduct the tax.

1420.150  **Where part of the trust income is received for foreign beneficiaries**

When the trustees have power to withhold income from non-resident beneficiaries, or the income is received for both New Zealand and non-resident beneficiaries:

(a) The responsibility for deducting the tax is not on the original payer but falls on the trustees at the time at which they pay or credit the income to the foreign beneficiaries.

(b) NRWT is deducted from the gross income allocated to each non-resident beneficiary, ie before deducting remittance costs or other direct expenses of that person.

(c) Where the trust income comprises income from various sources, such as dividends, interest, royalties, rent, and business or farming income, and there are both resident and non-resident beneficiaries, the trustees may choose to pay the shares of the non-resident beneficiaries out of the class of income (eg the business income), which does not attract NRWT, and pay the income of the local beneficiaries out of the dividends, interest, or royalties, or vice versa. However, imputation credits will be lost where dividend income is streamed [see 1420.130, 670.55].

**Example:**

A discretionary family trust has the following income:

* Australian sourced income of $500;
* Business income of $500;
* Interest income of $1,000; and
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1420.160

There are two beneficiaries of the trust, one resident in New Zealand, and the other resident in Australia. The trustees wish to distribute an equal amount to each beneficiary. To achieve the best tax position for the beneficiaries, the trustees would allocate the income as follows:

- Dividend income of $500.
- As foreign sourced income of a non-resident is not subject to tax in New Zealand, the $500 Australian sourced income would be allocated to the Australian beneficiary.
- As the $500 business income is not subject to NRWT, it would be allocated to the Australian beneficiary.
- As the $1,000 interest income would be subject to NRWT if allocated to the Australian beneficiary, it would be allocated to the New Zealand beneficiary.
- To maximise the benefit of imputation credits, the dividend income would be allocated evenly between the two beneficiaries.

The trustees would need to draft their resolution carefully so as to evidence the source of the income distributions.

(d) A discretionary family trust with income consisting of dividends, interest, or royalties (or a combination of them) may have income applied for the benefit of non-resident beneficiaries, e.g. in paying their personal life insurance premiums. NRWT must be calculated on a grossed-up amount to include both the premiums and the NRWT because the payment of the premiums is deemed to be income derived by the non-resident beneficiary.

Example:
A discretionary family trust has dividend income of $700 from which no NRWT has been deducted. The funds are used to pay a personal debt of a beneficiary who is not resident in New Zealand. The rate of NRWT applying to that beneficiary is 30 per cent. The NRWT liability in respect of the allocation of the $700 funds to the non-resident beneficiary is $300. This is arrived at by grossing up the distribution by the amount of the NRWT ($700 × 100/70) × 30 per cent = $300.

1420.160 Where the trustees deduct NRWT instead of the payer

Often the payer does not know the terms of the trust, or does not know that the trustees are receiving the interest, dividends, royalties, or know-how payments as agent of a non-resident beneficiary. In these cases, it is better for the payer and the trustee to arrange between themselves for the trustee to deduct and account for the NRWT. Where such an arrangement is made, the Dunedin branch of Inland Revenue (where absentee records are held), should be advised.

1420.165 When tax returns are not needed

NRWT is the final liability on company dividends and interest or investment society dividends paid to non-residents of New Zealand, where the payer and recipient are not associated persons. Estate or trust tax returns are therefore not needed if:

(a) All of the estate or trust income is from company dividends, and interest or investment society dividends;

(b) All of the beneficiaries are non-residents; and

(c) NRWT has been paid on the dividends and interest.

When the original payer does not deduct the NRWT, the responsibility rests on the trustees. If a trustee files an IR3 return on behalf of a non-resident beneficiary, it should be sent to:
Non-resident Centre
Inland Revenue
PO Box 1932
Dunedin
Call 0800 246 224
1420.170 Requirement for trustees to pay tax on behalf of beneficiaries

[ss HC 32, HD 12(1)]

The trustee is under an obligation to deduct tax from the beneficiary income or the taxable distribution, and the beneficiary may claim this amount as a tax credit when completing the annual personal income tax return (IR3).

Although, with effect from the 2004-2005 income year, distributions from a community trust cease to be exempt income, trustees of community trusts are not required to make deductions from amounts distributed by them.

The income of any person includes any beneficiary income and any taxable distribution derived. However, a distribution of tax-paid trustee income to a beneficiary is not income to the beneficiary. Where it is distributed after the later of six months after the end of the trust income year, or the date on which the trust’s return of income is filed (or required to be filed if earlier), it is not to be brought back in as beneficiary income. Beneficiary income takes precedence over trustee income and the income from the trust cannot be taxed as both beneficiary and trustee income.

Inland Revenue accepts the non-payment of tax by the trustee on beneficiary income and may assess the beneficiary directly where the trustees obtain the beneficiary’s permission and explain to the beneficiary the obligation to furnish returns and pay provisional tax. Inland Revenue looks to the trustee for payment in the event of default by the beneficiary or in the event of the arrangement proving unsatisfactory to the beneficiary.

Problems can arise for the beneficiary when trusts make a distribution of beneficiary income after the end of the beneficiary’s income tax year. The beneficiary would need to wait until the distribution was made before filing a tax return, or would need to file an amended return for the previous year when a subsequent distribution is made within the statutory time limit (see above) and that distribution relates back to the previous income year. The problem is further compounded when the trust has an approved late balance date and the beneficiary has a standard balance date.

The accounts (and possibly the tax return) of a trust for an income year may have been filed with Inland Revenue before the trust income has been paid or applied for the benefit of the beneficiaries within the six-month period following the close of the income year. If the return has not been filed by the time the income has been paid out, a statement setting out the position should be attached to the return, and if the return has already been filed, a letter to Inland Revenue giving the information is sufficient. Entries in the accounts for the following year should be made in such a way that Inland Revenue can follow the entries through. Income which is paid or applied within the statutory time limits cannot be counted a second time as beneficiary income in the subsequent income year. The appropriate share of the estate or trust income is also included in the beneficiary’s provisional tax calculations. The trustee is also obliged to pay provisional tax on beneficiary income as well as on trustee income. If the beneficiary income from the estate or trust is not known by the date for filing the beneficiary’s tax return, this should not delay filing the return, but a note should be included in the return form to the effect that “Income from interest in Estate (or Trust) of (name) not yet known”. Inland Revenue can be informed later of the amount.

Trustees are personally responsible to ensure that all tax is paid and should, before the trust assets are finally distributed, ensure that all income derived by the trust is returned for income tax purposes and that sufficient cash is retained to meet all taxation liabilities.

If a beneficiary is contingently entitled to income and capital on, for example, attaining a certain age, all of the income which has not been paid to, or applied for the benefit of, the beneficiary is assessable as trustee income. The total income for the year in which the contingency is met is met is assessable as beneficiary income.

Where a trustee who is also life tenant has, in breach of trust, failed to maintain the capital of the estate either by excessive realisation of assets or by neglecting to provide for depreciation of leasehold interests, and has been assessed on the whole income from the estate in each year, it may become necessary for the succeeding trustees to recover the amount of the deficiencies from the life tenant’s estate. The tax previously assessed on the life tenant’s income may be reviewed within the limitations of the Act in order to assess the correct
income to the life tenant in respect of previous years. The balance is assessed as trustee income. This usually results in a refund to the deceased life tenant’s estate, and is payable to the trustees of the head estate.

The CIR is empowered to reopen back year assessments, notwithstanding that the estate has been wound up and a final distribution made to the beneficiaries. Such an assessment would be raised on the administrator of the estate who would be responsible for the payment of the tax.

**1420.175 Assessment of tax payable by trustees**

The trustee pays provisional tax in the same manner as other provisional taxpayers. The amount is calculated on beneficiary income and trustee income.

Some tax credits are allowed in calculating tax on beneficiary income. Income taxes assessed against the returns filed by the executor are recoverable from the beneficiary: *Public Trustee v Flower* (1991) 13 NZTC 8,042 (HC).

**1420.180 Trust income tax return form (IR6)**

The correct income tax return form for declaring trust income is Form IR6. It shows the classification of the trust income into trustee income and beneficiary income. The same taxation concepts apply to inter-vivos trusts as to the estates of deceased persons. The form also reports on taxable distributions.

**1420.185 Directors’ fees**

If trustees, by virtue of holding shares in a company as part of a trust estate, become directors of the company, they must account to the trust for directors’ fees earned. These fees are treated as non-distributable income of the trust and are assessable as trustee income. A trustee is entitled to retain the remuneration personally only where the trust shares are not used to obtain the appointment as a director, or where the appointment as a company director is to replace the testator or settlor, and the trustee is empowered by the testator or settlor.

**1420.190 Bare constructive trusts**

A bare trustee is one who merely holds property on trust with no interest in or duty as to the trust property, except to convey it when required according to the wishes of the beneficial owner. A constructive trust is raised by the construction of equity in order to satisfy the demands of justice and good conscience without reference to any presumed intention of the parties. Some companies will not register an infant as a shareholder. Where the registration in the name of a nominee or trustee is simply for reasons of legal need because of the infancy of the true owner, Inland Revenue adheres to the long-standing practice of looking behind the status of the nominee or the possible constructive trust and assessing the income to the true owner.

**1420.195 Estates of deceased persons**

When a taxpayer dies, various taxation issues must be addressed. These can be classified into:

(a) Recently deceased taxpayers;
(b) Immediately distributable estates;
(c) Continuing trusts under an estate.

One of the first taxation matters that the personal representative of a deceased taxpayer attends to is the making of returns of income which the deceased would have been liable to make had he or she remained alive, make any other returns as may be necessary and to pay the tax assessed. The tax returns (IR3) that are furnished for periods up until the taxpayer’s date of death use the IRD number of the deceased person. After the taxpayer’s death, the personal representative holds the property of the deceased person as an administrator, executor, or personal representative. The estate becomes a new taxpayer with a new IRD number and the income of the estate is returned in an estate income tax return (IR6).


**Deemed disposals on death and distribution** [ss FC 1, FC 2, FC 3, FC 4, FC 5, FC 6, FC 7, FC 8]

**(1) Background**

The death of a person results in two deemed disposals. The first occurs at the time of the taxpayer’s death. The second occurs on the subsequent distribution of assets to the beneficiaries. In both cases the deemed disposal occurs at market value. The same market value applies to the deemed acquisition by the trust administrator or executor or by the beneficiary as the case may be. Only assets that are already in the tax base are affected. Assets such as the family home and personal chattels are generally excluded and can be ignored when determining whether rollover relief applies. Assets that are within the tax base are:

(a) Assets which have been depreciated for tax purposes;
(b) Assets held on revenue account;
(c) Financial arrangements, unless the deceased taxpayer accounted for the arrangements on a cash basis;
(d) Interests in a foreign investment fund.

**(2) Rollover relief**

Under s FC 3, transfers of assets to a spouse, civil union partner, or de facto partner on the death of a taxpayer are treated as a transfer of property under a settlement of relationship property under subpart FB. Therefore, they occur at tax book value where any other property that is within the deceased person’s tax base pass only to family members who are within the second degree of relationship to the deceased. The second degree covers spouses, parents, grandparents, children, grandchildren and siblings [see 960 MATRIMONIAL AND RELATIONSHIP PROPERTY].

Under s FC 4, transfers of a person’s estate to an executor or administrator on the death of a person and any subsequent transfer from the administrator or executor to the beneficiaries occur at tax book value where the following conditions are met:

(a) The only beneficiaries of the estate are any one or more of the person’s spouse, relatives of the deceased to within the second degree of relationship or charities;
(b) No life interest is established under the estate;
(c) Under the will or intestacy, no property of the deceased is required to be held in trust; other than for the period in which the property is subject to administration or executorship; and
(d) In the tax year during which the property is subject to administration or executorship, or in which it is held in trust for that purpose, the net income of the estate is distributed beneficially to the maximum possible extent.

A transfer of timber, standing timber, or a right to take standing timber, which is owned by a deceased person, occurs at tax book value where a person who is related to the deceased to within the second degree of relationship is beneficially entitled to the forest. This applies irrespective of whether a life tenant is entitled to part of the trust property and irrespective of who the trustees of the estate are [s FC 6].

The 10-year rules for land sales under ss CB 7 (Land dealing business), CB 8 (Land development or subdivision business), CB 9 (Business of erecting buildings), and CB 12 (Land affected by zoning changes) do not apply to a transfer of an interest in land to the administrator or executor and the subsequent transfer to the beneficiaries, where the property passes to a person related to the deceased person to within the second degree of relationship.

A deduction is allowed against the deemed proceeds for the original cost of the land to the deceased person and all other costs incurred, whether by the deceased or by the executor or administrator, if the person to whom the land is transferred:

(a) Later disposes of it within 10 years of its acquisition by the deceased person; and
(b) As a result of this disposition, income would arise under any of those sections [s FC 5].
Under s FC 7, prepayments are valued at cost when transferred to the administrator or executor and again when transferred to the beneficiary.

Financial arrangements are transferred at cost where the deceased person was a cash basis person as at the date of death. This applies to both the transfer to the administrator or executor and a subsequent transfer to a beneficiary [s FC 8]. For examples see TES 28 (July 2005) 417, 418, 419, 420, 421.

**1420.200 Returns for period prior to death to be furnished** [TAA, s 43]

The executor or administrator of a deceased estate must file income tax returns for the period prior to date of death as follows:

(a) A return of income derived by the deceased for the year ended on the preceding 31 March (or other balance date), if not already furnished. Note the special provisions exempting pay-period taxpayers from filing returns.

(b) A return of income derived during the current income year from the end of the previous income year to the date of death. This should be furnished even if the deceased would otherwise be a pay-period taxpayer.

In these circumstances, a personal income tax return (IR3) is filed.

The provisions relating to income statements [see 1270.75] and taxpayers not required to furnish tax returns [see 1270.70] do not apply to individuals who act in the capacity of executors or administrators of deceased taxpayers.

**1420.205 Income tax return to date of death**

The income, which is deemed to be derived by the deceased person in the period from the last balance date to the date of death, includes:

(a) All interest, annuities, superannuation, and rents actually received during the period.

(b) All fees actually received during the period.

(c) All salaries and wages actually earned during the period, irrespective of the date of payment including back pay authorised before the taxpayer’s death.

(d) All business income earned during the period.

(e) All dividends derived or declared payable during the period prior to death.

(f) The balance of any income received in advance and which the CIR has permitted to be returned as income over a period of years. This includes income received by way of anticipation, income from compulsory acquisition of land, and income from sale of patent rights.

(g) Any deposits that a taxpayer has in a farm income equalisation account, unless the trustee elects in writing either to:

   (i) Have the whole or part assessed as income derived during the lifetime of the deceased in the earlier years in which the relevant deposits were deducted. An amendment to earlier assessments may be made notwithstanding the statutory time limits for reassessment; or

   (ii) Spread the amount, or any part of it, forward into any of the three years after the death but limited to the balance of the maximum five-year deposit term, in which case the funds so allocated to each of the succeeding years must remain in the reserve account until the time specified in the application. It eventually becomes trustee income.

(h) The excess value of any commercial bill owned by the deceased over the cost to the deceased of the bill. A person who dies, owning a commercial bill, is deemed to have sold the bill on the day of death. The difference between the cost of the bill and its value at the date of death represents income derived during the lifetime by the deceased.

Where returns have properly been made on an earnings basis by the deceased taxpayer, the trustee should furnish the return to the date of death on an earnings basis. This applies in general to business and farming...
profits. Where returns have properly been made on a receipts basis (eg rents, interest) by the deceased taxpayer, the trustee should furnish the return to the date of death on a receipt basis.

1420.210 **Tax returns for period after death**

The income derived by the estate after the date of death must also be furnished in an income tax return for as long as the estate or testamentary trust remains undistributed. An IR6 income tax return form is used.

A decision has to be made about which tax return (the IR3 before death, or the IR6 after death) should account for income that straddles the date of death. Income accrued to the date of death and received subsequently by the trustee is assessable as trustee income and included in the estate income tax return (IR6). All income accrued to the date of death, which is not assessable as income derived by the deceased taxpayer in the final IR3, must be returned by the trustees in the estate income tax return, even though the whole of the estate may pass immediately to beneficiaries who are absolutely entitled in possession to the corpus and income of the estate. It forms part of the capital of the estate [ss HC 8, CV 12].

1420.215 **Special points relating to income**

(1) **Advances owing to partnership by deceased partner**

Where A and B are in partnership, and B dies with money owing to the partnership while A continues the partnership business, the following apply:

(a) Until B’s share is transferred to B’s trustees, A is bound (unless the partnership deed provides to the contrary) to account to B’s trustees for:
   - The share of income to which B, if alive, would have been entitled to; or
   - Interest on the deceased’s assets, as the trustees may elect [Partnership Act 1908, s 45].

(b) If A applies the resultant partnership income of B’s estate to reduce B’s indebtedness to the firm, the income is not applied for the benefit of B’s beneficiaries during the income year, and neither is it income to which the beneficiaries are entitled during the year. Accordingly, that income up to the date on which A covenants to take over all partnership assets and debts is assessable as trustee income.

(2) **Bonuses for dairy, meat, and fruit produce sold**

Bonuses accrued to the date of death on produce supplied up to that date, although received by the trustee, are assessable as income derived by the deceased in the period to the date of death. This is so, notwithstanding that, during the farmer’s lifetime, it was permitted as a matter of convenience to return the bonuses as income as and when received.

(3) **Business income**

If trustees carry on a business with the express authority of the beneficiaries but with no power under the will, they are regarded as agents for the beneficiaries and are not trustees. Consequently, the beneficiaries are really partners and both income and losses are transferred to them.

(4) **Dividends accrued**

Where dividends are actually derived in the period after death, no apportionment should be made under the Property Law Act 1952 unless the dividend resolution expressly states that it is for a fixed period of time which commences before and ends after the date of death. Where an apportionment is to be made, the part applicable to the period before death is assessable as trustee income, while the part for the period after death is assessed as either beneficiary income or as trustee income according to the terms of the will. In no case is any part of the dividend treated as the income of the deceased.

(5) **Financial arrangements income**

Financial arrangements income accrued in the period to date of death and received subsequently is income to be included in the estate tax return (IR6), unless it is interest which may be uplifted with the capital at any time on demand.
(6) **Holiday pay accrued**
Where employment is terminated by the death of the employee, the holiday pay for holidays due but not taken at the date of death is payable to the trustee and is assessable as trustee income, and not as income derived in the period up to the date of death.

(7) **Income from other estates**
Where the deceased was a beneficiary in an estate carrying on a business, the deceased’s income from the estate to the date of death is the amount of cash available for the beneficiary to that date, unless the estate’s accounts are actually balanced at the date of death so that the correct income due to the beneficiary is ascertained. Where the deceased was in receipt of income from an estate with all its assets invested, the income deemed to be derived by the beneficiary to the date of death is the share of income received on his or her behalf by the trustees of that estate up to the date of death.

(8) **Interest**
Interest, which may be uplifted with the capital invested at any time on demand, such as interest from a bank savings account or from current accounts with stock firms, is considered to be derived on a day-to-day basis and the proportion accrued up to the date of death is assessable as income of the deceased, irrespective of the date received. It is included in the personal income tax return (IR3).

(9) **Interest on advances made to a beneficiary**
A beneficiary entitled to a share in an estate may have obtained a prior advance against that share, with interest payable on the advance. Where advances are made to a beneficiary in accordance with the terms of the will, and the advances, together with interest at a fixed rate, are brought into account for the purpose of ascertaining the shares of the beneficiaries, the interest is merely notional interest charged for the purpose of adjusting the respective shares of the beneficiaries and is not real interest for taxation purposes. The interest on the advances is credited to the estate in order to increase the share of the other beneficiaries but is deducted from the share of the beneficiary who received the advances.

In other cases, a proportion of the interest is returned as income in the distribution by the trustee of the estate income; and the position of the beneficiary from a taxation point of view is as follows:

(a) The “mutuality principle” that taxpayers cannot derive a profit from dealing with themselves does not apply. The interest is payable by the beneficiary to the trustee and not to the beneficiary. The fact that the beneficiary derives part of the income from the trustee does not prevent the interest from being real interest which is ultimately income.

(b) The interest payable by the beneficiary is allowable as a deduction only where a nexus exists between the interest payable and the income earned from the borrowing.

(10) **Partnership income**
Where the deceased derived income from a share in a partnership business, the partnership trading stock on hand at the date of death must be brought into account at the probate valuation, and a return of the partnership income derived to the date of death should be furnished on this basis. Where the deceased derived income from partnership investments, ie from interest, rents, or dividends, the income derived by the deceased partner for the period to date of death is the share of the income actually received by the partnership during the period.

(11) **Rents accrued**
Rental income is considered to accrue on a day-to-day basis and any rent accruing but unpaid at date of death should be returned as income of the deceased. It is included in the personal income tax return (IR3).

Where rents from more than one property have accrued at date of death, it is necessary, when computing the deductions allowable for rates, insurance, interest, and depreciation, to consider each property separately and to allow for each property a proportion of the fixed charges equivalent to the period of time over which the accrued rents were being earned.
(12) Solicitors recently deceased

Fees, to the extent to which they are billable by a deceased solicitor prior to the date of death, should be included in the returns of the deceased up to the date of death, even though they were not rendered prior to the date of death. Fees, to the extent to which they were not billable as at the date of death, and for which work has since been completed by or on behalf of the trustees, should be included in the estate return in the year in which the work was completed and the fees rendered by the trustees. These fees are assessable as trustee income.

1420.220 Allowable deductions

In calculating net income, the following special features apply.

(1) Bad debts

For bad debts written off by trustees [see 90 BAD DEBTS AND BAD DEBTS RESERVES].

(2) Depreciation

Where the beneficiaries have an absolute vested interest in an estate property from which income is derived, depreciation is deductible when calculating net income.

However, where a person has a life interest only in the income produced by the property, no depreciation can be allowed against that beneficiary’s income because no losses are sustained by that person through the diminution in the value of the property. An exception is made where a reserve for depreciation is created out of income and the income reserved is credited to capital in terms of a power conferred on the trustees. Trustees have this power in the following cases:

(a) Where the person with a life interest is entitled to the net profits from a business (not rents) the trustees may charge depreciation in ascertaining the net profits; and

(b) Where there is a trust for conversion, with or without power to postpone conversion, depreciation may be deducted, except where the will provides that, pending conversion, the beneficiary is to receive the actual income from the unconverted assets.

Where all estate income is assessable as beneficiary income, depreciation is allowable as a deduction from the beneficiary income from the estate assets according to the beneficiary’s vested interest in the assets. Where income is assessable partly as beneficiary income and partly as trustee income, with the latter income including no non-deductible items of expenditure, the depreciation is apportioned between the beneficiary income and the trustee income according to the vested capital shares in the assets.

Where the income is assessable partly as beneficiary income and partly as trustee income and the trustee income consists partly or wholly of non-deductible expenditure, the depreciation is allowed as follows:

(a) The total depreciation allowable on income-producing assets is first divided amongst the beneficiaries with vested capital shares in proportion to their respective capital shares. This gives the loss sustained by each beneficiary by reason of depreciation.

(b) The depreciation so allocated to each beneficiary is then allowed:

(i) First, against income to which that beneficiary is actually or constructively entitled (ie if the beneficiary is an adult or a minor with a vested interest, against income assessable as beneficiary income); and

(ii) Secondly, against any non-deductible items assessable as trustee income.

(c) Where a capital share is not vested in any beneficiary but is held for beneficiaries contingently entitled, depreciation is not allowable against the income derived from that contingent share unless both the capital and income of the contingent share are held in trust so that the beneficiaries ultimately entitled to the contingent share also become entitled to both capital and accumulated income from that share.
Where a deduction for depreciation or expenditure allowable against trustee income creates a loss because it either exceeds that income (or there is no such income in the particular year), the loss may be carried forward and offset against future trustee income.

**Example:**
The trustees return income derived during the year from a property is as follows:

<table>
<thead>
<tr>
<th>Items</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rents received</td>
<td>$22,500</td>
</tr>
<tr>
<td>Expenses:</td>
<td></td>
</tr>
<tr>
<td>- Rates</td>
<td>$1,500</td>
</tr>
<tr>
<td>- Insurance</td>
<td>$1,000</td>
</tr>
<tr>
<td>- Interest</td>
<td>$4,000</td>
</tr>
<tr>
<td>- Repairs</td>
<td>$10,000</td>
</tr>
<tr>
<td>Total expenses</td>
<td>$16,500</td>
</tr>
<tr>
<td>Net income</td>
<td>$6,000</td>
</tr>
</tbody>
</table>

The repairs consist of $10,000 spent in remodelling shop fronts which is not deductible for taxation purposes.

One beneficiary, a son, has a vested share in one-half of the estate and the other beneficiary, a daughter, has a life interest in the income of one-half of the trust property, with the remainder to her children absolutely on her death. Depreciation on buildings amounting to $9,000 is deductible. Income for the year is calculated as follows:

**The son:**
- Assessed as beneficiary income: $3,000
- Less depreciation: One-half of $9,000 = $4,500. Allow $3,000
- Income: nil

No tax is payable. Note that the balance $1,500 of the beneficiary’s share of depreciation is allowed against the trustee income.

**The daughter:**
- Assessed as beneficiary income: $3,000
- Depreciation: nil
- Income: $3,000

Income tax is payable on $3,000.

**The trustee:**
- Income assessed: $10,000
- Less depreciation allowable: $9,000
- Allowed to son: $3,000
- Net: $6,000
- Income: $4,000

Income tax is payable on $4,000.

Where a beneficiary in a farming estate is employed as the farm manager and is entitled to the sole use of the homestead, the trustees are allowed depreciation at the full rates on the homestead. Where the homestead is occupied by a beneficiary manager jointly with other beneficiaries who are in occupation not as employees but as beneficiaries, the trustees are entitled to a deduction of one-quarter of the depreciation on the homestead. Depreciation is allowable for vacant farm buildings ordinarily used for farming, unless there is something more than a temporary cessation of use.

**3) Expenses allowable in period to date of death**

In calculating income in the period to date of death, the expenses deductible from the income derived to the date of death are as follows:
(a) A proportion of the fixed charges (ie rates, interest, insurance, rents, and depreciation) calculated on a day-to-day basis over the whole year (according to the Property Law Act 1952), diminished by the amount of any expenses deductible against any income accrued to the date of death and received subsequently by the trustees.

(b) Expenditure other than fixed charges (ie repairs and legal costs) are deductible from the income derived to date of death in the period when they were incurred regardless of when they were paid.

(4) Farm development expenditure

Development expenditure is deductible against trustee income. If this results in a net loss, the usual rules governing the carry forward of losses apply to permit the loss to be offset against future trustee income.

Development expenditure may be claimed against beneficiary income only in the following circumstances:

(a) When a life tenant under the terms of a will has the free use, income, and enjoyment of an estate and carries on the estate business personally, development expenditure may be deductible and be claimed against the life tenant’s income.

(b) When expenditure is actually charged in the accounts to the life tenant and the cost is borne by the life tenant, development expenditure may be claimed against the income. This does not apply if the trustees intend to refund the amount, directly or indirectly, at a future time or the amount is borne by the life tenant as a loan or advance from accumulated income.

(c) When a beneficiary has a vested interest in the capital of the estate, the development expenditure may be set off against the income.

(5) Interest on legacies

Interest on legacies is not a deductible expense in calculating the income in any year. Income paid to legatees is a distribution of the trust income and if actually paid to or applied for the benefit of a legatee, is beneficiary income.

(6) Legal expenses

Legal expenses are not deductible if incurred for the following purposes:

(a) In connection with the capital administration;

(b) The distribution of income to the beneficiaries;

(c) The appointment of new trustees.

Legal expenses incurred by estate trustees for the purposes of defending a testamentary promises claim were held to be expenditure of a private or domestic nature prohibited from being deductible: TRA Case L53 (1989) 11 NZTC 1,304.

Legal expenses incurred in applying to the Court for trustee remuneration are treated in the same way as trustee remuneration and allowed as a deduction in the same proportion as the remuneration is deductible.

(7) Livestock values

In the first estate return, the commencing value of the livestock is the value of the livestock entered as the closing value in the return to the date of death (ie market value).

(8) Losses carried forward

A loss incurred by a deceased taxpayer cannot be offset against income derived subsequently by the estate because the estate is a new taxpayer with a new tax file number.

When a loss has been incurred by trustees in an estate, the will should be examined to ascertain whether the loss should be borne by corpus or income. If the will provides that losses are to be borne by corpus, and does not grant a trustee with power to make reservations from income, the trustee is not deprived of any statutory right to carry the losses forward for offset against future profits. A life tenant may receive the income each year without making good any previous losses. However, the trustee may have the right to offset previous losses incurred against any business income.
Beneficiary income cannot be calculated as a negative amount through the estate incurring a loss. A loss incurred by an estate in any year cannot be offset in a life tenant’s individual assessment against the income derived by the life tenant from other sources during the same year. Neither can it be carried forward and offset against a life tenant’s income from the estate in a subsequent year. However, where the beneficiaries have a vested share in both the income and capital of the estate, the trustees are entitled to carry forward and offset the loss against future beneficiary income.

A loss incurred by an estate may be carried forward in the estate and offset against trustee income derived in future years. This applies even if the will directs that the loss must be made good out of corpus. A trustee may carry forward losses and have them offset against future income even though the income would otherwise normally be assessable as beneficiary income: Rutherford v Commissioner of Inland Revenue [1965] NZLR 444 (CA).

Where a will gives power to a trustee to carry on a business formerly conducted by the deceased, and power to make provision for depreciation, losses incurred in one year may be carried forward to future years.

Expenditure incurred by trustees in attempting to mitigate losses made in connection with shares held by the trustees was non-deductible, being capital expenditure incurred to preserve capital assets of the trust fund and not in the course of any business activities which had by then ceased: TRA Case J39 (1987) 9 NZTC 1,225.

(9) Repairs and maintenance

The cost of repairs needed to an estate property at the testator’s death are not deductible if the repairs place the property in a better condition and a capital improvement is made.

(10) Repairs recouped from beneficiary income

A trustee is empowered to carry out repairs from the capital of the estate and recoup the cost of the work from future beneficiary income [s 15(1)(a) of the Trustee Act 1956]. The amount recouped is not income available to the income beneficiaries and is assessable as trustee income. Where the expenditure exceeds the trustee income for the year, the loss of trustee income is carried forward and offset against future trustee income.

Example:

In the first year rental income is $30,000. Repair expenses of $12,000 are paid by the trustee but withheld from the beneficiaries under s 15(1)(a) of the Trustee Act 1956 over a period of three years.

<table>
<thead>
<tr>
<th>First year:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental income</td>
<td>$30,000</td>
</tr>
<tr>
<td>Less repairs recouped by trustee</td>
<td>$4,000</td>
</tr>
<tr>
<td>Beneficiary income</td>
<td>$26,000</td>
</tr>
</tbody>
</table>

| Trustee income (repairs recouped) | $4,000 |
| Less repairs incurred | $12,000 |
| Trustee income (loss carried forward) | $8,000 |

<table>
<thead>
<tr>
<th>Second year:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental income</td>
<td>$30,000</td>
</tr>
<tr>
<td>Less repairs recouped by trustee</td>
<td>$4,000</td>
</tr>
<tr>
<td>Beneficiary income</td>
<td>$26,000</td>
</tr>
</tbody>
</table>

| Trustee income (repairs recouped) | $4,000 |
| Less loss brought forward | $8,000 |
| Trustee income (loss carried forward) | $4,000 |

<table>
<thead>
<tr>
<th>Third year:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental income</td>
<td>$30,000</td>
</tr>
</tbody>
</table>

Staples Tax Guide 2012
(11) Trading stock

Trading stock on hand at the date of death should be brought into account at its true value (i.e., probate value).

(12) Trustee remuneration

Only the proportion of the trustee charges related to the production of income are deductible. Any amount which relates to the administration of the capital assets and to the distribution of income is not deductible.

Trustee remuneration payable under a court order obtained by the trustees is assessable in the year of receipt, notwithstanding the fact that the services for which the payment is made were performed over a period of years. The trustees are not actually entitled to any remuneration until the court order is obtained.

Where the trustee is bequeathed shares as consideration for agreeing to act as trustee under the will, the market value of the shares is assessable as income in the year of receipt.

1420.225 Person who administers an estate under the Aged and Infirm Persons Protection Act is not a trustee

A person appointed to control and administer the estate of an infirm person under the Aged and Infirm Persons Protection Act 1912 is not a trustee but a manager and, therefore, an agent of the aged or infirm person. The manager is deemed to be a trustee for the purposes of the Trustee Act 1956, but not for the purposes of the ITA 2007. Consequently, the returns of income which the manager is required to make are not trust tax returns, but are personal income tax returns.

1420.230 Valuation of assets where existing trusts become subject to New Zealand tax [s HC 31]

Where a trust which was previously not liable to New Zealand income tax on trustee income becomes liable, the cost for tax purposes of items such as premises, plant, machinery, equipment, and trading stock is deemed to be (at the option of the person liable to pay income tax on trustee income) either:

(a) Historical cost less accumulated depreciation or a value (being no higher than market value) at that date used for the purposes of income tax calculations in any country in which the trustee income has been liable to income tax; or

(b) The value which would be used as if the trustee income had at all times been liable to income tax.

The acquisition price of any financial arrangement is (at the option of the person), either:

(a) Market value; or

(b) The result of the following formula:

\[ \text{consideration paid to the person} + \text{expenditure} - \text{consideration paid by the person} - \text{income}. \]

1420.235 Disclosure [TAA, ss 93B, 59]

Where a New Zealand resident makes a settlement on a trust on or after 17 December 1987 and, at the time of settlement, no trustee was resident in New Zealand, or if subsequently there is no trustee resident in New Zealand, the settlor must disclose to the CIR by the later of three months from the date of settlement or the date of there being no trustee resident in New Zealand, the fact of that settlement, the names and addresses of trustees and beneficiaries, and such other details the CIR may require [TAA, s 59].
Any person who has made a settlement on a trust as nominee for any other person where, at the time of settlement, no trustee was resident in New Zealand, must disclose to the CIR by the later date of within three months of settlement or by 31 May 1989 of the fact of the settlement, the name and address of the person deemed a settlor, and any further details required by the CIR.

The disclosure requirements do not apply to any trust that is a superannuation fund.

Where disclosure has not been made or insufficient information is available to calculate trustee income, the CIR may determine the amount of trustee income for the income year in a fair and reasonable manner [TAA, s 93B].
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1440.10  Purposes of the Unclaimed Money Act

The Unclaimed Money Act 1971 has these purposes:

(a) To ensure people or organisations who hold funds on behalf of someone else take adequate steps to find the owners of unclaimed deposits and other amounts owing;

(b) To enable businesses and the personal representatives of deceased people to clear their accounts of unclaimed money;

(c) To require unclaimed money be paid to the Crown as the custodian for the owner of the funds, with the benefit from the use of the money accruing to the community in the interim; and

(d) To establish a mechanism for the owner to recover the unclaimed money at a future date.

The Act sets out the procedures to follow for unclaimed money. It defines unclaimed money and holders of unclaimed money. Generally, money held in an account where there is no activity for six consecutive years (or 25 consecutive years, for some deposits), becomes unclaimed money. There are special provisions for amounts of $100 or less.

The Act applies to all companies, banks, building societies, insurance offices, moneylenders, auctioneers, real estate agents, accountants, sharebrokers, and motor vehicle dealers that hold defined classes of unclaimed money. There are special provisions where the holder has ceased to carry on business or has died. The CIR may also enter into special arrangements to exempt holders from some of the administrative requirements of the Act.

The Act does not apply where provisions relating to unclaimed money exist under other legislation, eg for solicitors. However, any person or organisation who is not required to comply with the Act may elect to become a holder, and use the facilities to clear unclaimed money.

The Act sets out the obligations of holders and the CIR for unclaimed money held on behalf of the owner. Inland Revenue administers the Act on behalf of The Treasury.

1440.20  Unclaimed money

Unclaimed money falls into three broad groups:

(a) Deposits of money;
Unclaimed Money

(b) Life assurance proceeds;
(c) Certain types of trade debts.

Money only becomes unclaimed money after it has been held for a certain length of time and it is situated in New Zealand. Money unclaimed in another country is generally subject to that country’s law.

The following money is treated as unclaimed money.

1) **Fixed term deposits**

Money (including interest), deposited by the customer to earn interest for a fixed term. The money becomes unclaimed money if the holder has held the money for six years after the end of the fixed term.

2) **Deposits for indefinite periods**

Money (including interest) deposited by the customer to bear interest for an indefinite period, eg an ordinary savings account. The money becomes unclaimed money if the customer has not used the account for 25 years by making a deposit, withdrawing money, or giving written instructions.

3) **Automatically renewable fixed term deposits**

Money (including interest) deposited by the customer to bear interest for a fixed period where the money is automatically reinvested at the end of the term. For example, the customer may give a written standing instruction that the holder should reinvest the deposit on the expiry of each deposit term. This money becomes unclaimed money if the customer has not used the account for 25 years by making a deposit, withdrawing money, or giving written instructions.

4) **Non-interest bearing current accounts**

Money deposited by the customer in a current account which does not bear interest. The money becomes unclaimed money if the customer has not used the account for six years by making a deposit, withdrawing money, or giving written instructions. If the amount is held by a savings bank, the money becomes unclaimed if the customer has not used the account for 25 years. Savings banks include the Post Office Bank Ltd, trustee savings banks, private savings banks, and building societies.

5) **Life assurance proceeds**

Money payable on the maturity of a policy of life assurance. This money becomes unclaimed if held by the holder for longer than six years after the earlier of the date that the policy matures (otherwise than by death) or the date that it matures due to death. The holder only needs to have reason to suppose that the policy has matured due to death. The holder does not need to ensure that the death is legally proved, even if this is a condition of the life assurance policy itself. Example: If a policy holder disappears while swimming, the six-year period starts to run from the date of the probable drowning, although the death may not be legally presumed until later.

6) **Trade debts and other money**

Any other money which has been owing by a person who is defined as a “holder” (explained below). Examples of money falling into this group include trade debts, wages, and unpresented cheques. This money becomes unclaimed money if it has been owing for six years after the due date for payment.

7) **Case law**

In *Westpac Banking Corporation v Commissioner of Inland Revenue* (2009) 24 NZTC 23,076 (HC), the High Court found that bank cheques and foreign currency drafts not presented for payment are unclaimed money within the meaning of s 4(1)(e) of the Unclaimed Money Act 1971. The decision was confirmed by the Court of Appeal in *Westpac Banking Corporation v Commissioner of Inland Revenue* [2009] NZCA 376, (2009) 24 NZTC 23,755. Westpac has been granted approval to appeal the case to the Supreme Court.

1440.30 **What is not unclaimed money**

Three types of money can never become unclaimed money (except where the holder or person owing the money ceases business [see 1440.62]). These are:
(a) Dividends: This exclusion does not apply to dividends payable by mutual associations if the dividends are effectively interest on members’ contributions or deposits;
(b) Mutual association rebates: This exclusion applies to rebates on store trading payable by mutual associations to their members Interest on members’ contributions or deposits can become unclaimed money; and
(c) Benefits payable from a pension or superannuation fund.

In *Commissioner of Inland Revenue v Thomas Cook (New Zealand) Ltd* [2003] 2 NZLR 296 the Court of Appeal held that international cheques (drafts) that are not presented by the payee become unclaimed money when they become stale. The drawer is not liable on a cheque until it is presented at a bank for payment. If it is not presented, the drawer becomes liable for payment when the cheque becomes stale (six months after the date of the draft). At this point, the drawer has an immediate and unconditional obligation, and the money is payable at this time for the purposes of s 4(1)(e) of the Unclaimed Money Act 1971.

On appeal, the Privy Council confirmed that Thomas Cook (New Zealand) Ltd was obliged under s 8 of the Unclaimed Money Act 1971 to pay to the CIR the amount of the unpresented cheques. The Council questioned the Court of Appeal’s finding that the cheques became payable when they became stale, and found that the cheques were payable on issue: *Thomas Cook (New Zealand) Ltd v Commissioner of Inland Revenue* (2004) 21 NZTC 18,933 (PC).

In *Westpac Banking Corporation v Commissioner of Inland Revenue* [2011] NZSC 36 the taxpayer banks brought proceedings against the CIR to determine whether certain categories of bank cheques and foreign currency drafts were unclaimed money within the meaning of s 4(1)(e) of the Unclaimed Money Act 1971. The banks’ position was that, when bank cheques or drafts were not presented for payment, the banks, as issuers, were not the holders of unclaimed money and therefore not liable to record particulars or pay the unclaimed amounts to the CIR.

The High Court granted the CIR’s application for summary judgment and declarations finding that the unpresented bank cheques and foreign currency drafts were unclaimed money within s 4(1)(e). The Court of Appeal dismissed the taxpayers’ appeal finding that it was bound by the Privy Council’s decision in *Thomas Cook*, as there were no material differences in the facts of the cases in relation to the form, use or practice of the instruments.

The Supreme Court held that the Privy Council was correct in its decision and interpretation of the relevant law in *Thomas Cook*. That decision applied to foreign drafts and bank cheques and the banks were not entitled to retain the money that was paid under them. Therefore, six years after their purchase, the money represented by those financial instruments became unclaimed money under s 4(1)(e).

The Supreme Court considered the meaning of “payable” in s 4(1)(e) and held that, in this case, customers were in substance putting the taxpayers in funds, against which both the customer and bank expected a third party to draw. Where that expectation was not fulfilled, the situation was covered by one of the purposes stated by the Minister in his speech introducing the Bill in 1971, that money in the hands of another and which is not claimed by the owner is not to be retained and treated as the holder’s revenue.

**1440.40 Other legislation**

The Unclaimed Money Act does not override any special provisions for the treatment of unclaimed money contained in any other Act. Other Acts that include such special provisions are:

(a) The Law Practitioners Act 1982;
(b) The Companies Act 1955 and the Companies Act 1993 (liquidations);
(c) The Innkeepers Act 1962;
(d) The Public Trust Office Act 1957.

**1440.50 Holders**

Holders of unclaimed money fall into one of the following three groups:

(a) General mandatory holders;
(b) Restricted mandatory holders;
(c) Voluntary holders.

(1) General mandatory holders
These are companies, banks, building societies, and insurance offices. General holders are liable to account for all classes of unclaimed money.

(2) Restricted mandatory holders
There are certain holders (who are not companies) who are only obliged to account for particular kinds of unclaimed money. These holders, and the unclaimed money they must account for, are:
(a) Moneylenders: Money they have borrowed in the course of the money lending business;
(b) Auctioneers: The balance of any proceeds of goods sold at auction;
(c) Real estate agents: Money held in the real estate agent’s trust account;
(d) Sharebrokers: Money held on behalf of clients;
(e) Members of the New Zealand Institute of Chartered Accountants (NZICA): Money held on behalf of clients; and
(f) Motor Vehicle Dealers: Proceeds a dealer receives when acting as agent.

(3) Voluntary Holders
Any person, firm, body, or institution not included above may elect to be a holder and comply with the provisions of the Act. In addition, any of the restricted holders mentioned above may elect to be a holder of additional money except:
(a) Money which they hold as a mandatory holder; and
(b) Funds which do not qualify as unclaimed money (eg dividends, mutual association rebates, or pension and superannuation fund benefits).

Any person (or personal representative) may elect to be a holder where the business has ceased or death has occurred.

Before the CIR can accept the unclaimed money held by a person who has elected to be a holder, the person must give the CIR a copy of the entry in the holder’s unclaimed money register. In the case of business cessation or death, the holder must give the CIR brief details of the money and its owner.

1440.51 Requirements for holders
On 1 June each year, holders must enter in an alphabetical register details of unclaimed money arising in the preceding year. The register must be available for inspection by the public.

By 30 June each year, the holder must send a letter to each owner (at the last known address), providing details of the unclaimed money.

By 30 September each year, the holder must advise the CIR of the entries made in the register.

If the money is not claimed by the owner, the holder must pay it to the CIR according to the requirements set out below.

The holder must make an election for amounts not exceeding $100 for any one owner according to the requirements set out below.

The CIR may authorise officers to examine at any time any register kept by a holder and any accounts of the holder that relate to unclaimed money. The officer may require the holder to correct any errors in the register.

1440.60 Payment of unclaimed money
The money is payable to the Crown through the CIR when:
(a) The money is deemed to be unclaimed money;
(b) It has been held unclaimed for the required number of years (six years or 25 years as applicable); and
(c) It is held by a holder.

The holder of unclaimed money in any year ending on 31 May, where either the money has not been paid to
or claimed by the owner by 30 September, must pay the money to the CIR by 31 October. Where the holder
pays unclaimed money to the CIR in accordance with the Act, the holder has no further liability to anyone
who claims the money.

1440.61 Amounts of $100 or less

There are special provisions to overcome the expense of handling small amounts of unclaimed money that
do not exceed $100 for any one owner. A holder can choose within 12 months after the end of the six-year
or 25-year period not to search out owners and not to pay the unclaimed money to the Crown. The money
ceases to be unclaimed money. The holder can apply the amount for personal benefit or for the benefit of
any other person or for any purpose or object. The owner can still claim the money from the holder in the
future.

1440.62 Where the holder has ceased business or died

Where a business ceases or a death occurs, money that has been held unclaimed for six months after cessation
or death may be paid to the Crown to hold as custodian. This applies to money which would:

(a) Become unclaimed money when the time limits expired; or

(b) Have become unclaimed money if it had not been one of these items:
   (i) Dividends;
   (ii) Rebate from a mutual association to members for trading transactions; or
   (iii) Benefits payable from any pension or superannuation fund.

This is an option that assists in the early clearing of books, and is available to anyone who ceases business
or in the event of death.

1440.63 Role of Inland Revenue

The CIR administers the Act on behalf of The Treasury. All unclaimed money received is paid into the
Consolidated Account. The Act provides that all Inland Revenue officers must maintain secrecy about all
information obtained in administering the Act. Inland Revenue only communicates such information for the
purpose of administering the Act. There is one exception to this strict secrecy requirement; the CIR may
make available for publication the names of owners and amounts of unclaimed money paid to the CIR.

1440.64 Special arrangements

The CIR may enter into a special arrangement in writing to exempt any holder or class of holder from the
following obligations:

(a) Keeping an unclaimed money register;

(b) Notifying owners (although this particular exemption would be rare);

(c) Supplying register entry copies to the CIR; and

(d) Paying unclaimed money to the CIR by 31 October, where no person has established a valid claim
    by 30 September.

1440.65 Repayment of money

If a claimant establishes a valid claim for unclaimed money paid to the Crown, the CIR repays the money
out of the Consolidated Account. A claimant must satisfy the CIR that he or she is the owner of the money.
There are no specific rules as to what is satisfactory evidence of ownership. In some cases it may be necessary
to consult the former holder. For example, Inland Revenue might consult a former holder such as an insurance
company or bank, for comparison of signatures or other evidence. Where the CIR pays money to a claimant
and another person later claims to be the owner, the CIR is not responsible for repayment. The second claimant
may have a claim against the first claimant.
Inquiries about unclaimed money should be made to:
Unclaimed Money,
BusinessDirect,
Inland Revenue Department,
PO Box 895,
Wellington.

1440.70 Offences
It is an offence for a holder to wilfully or negligently fail to comply with the Act. Where the holder is a company, both the company and the executive officer who authorised or permitted the failure are open to prosecution. The Court can impose a fine of up to $500 upon conviction for each offence [see TIB vol 5:7 (December 1993)].
Chapter 1450
Unit Trusts

1450.10 Unit trusts
A unit trust is treated as a company, the unit holders are treated as shareholders and the income and other payments to the unit holders are treated as dividends. The remuneration paid to the manager and to the trustee of the unit trust is deductible from the income of the trust. Public ruling BR Pub 95/5A sets out the relationship between a unit trust and a qualifying trust [see TIB vol 8:10 (December 1996) at 15]. On 20 April 2000, the CIR issued a notice of non-renewal of BR Pub 95/5A (ie the ruling is no longer binding on Inland Revenue). However, the CIR also stated that Inland Revenue’s approach to the issue remained the same.

A unit trust does not include the following:
(a) A trust for the benefit of debenture-holders;
(b) The Common Fund of the Public Trustee or any Group Investment Fund established by the Public Trustee;
(c) The Common Fund of the Maori Trustee;
(d) Any Group Investment Fund established under the Trustee Companies Act 1967;
(e) Any friendly society registered under the Friendly Societies and Credit Unions Act 1982;
(f) Any superannuation fund;
(g) Any employee share purchase scheme in terms of s DC 12;
(h) Any employee funeral trust in terms of s CW 45; or
(i) Any other trust declared by the Governor-General, by Order in Council, not to be a unit trust for these purposes.

Small investment clubs may not come within the scope of the section. Before the provisions can apply, the scheme or arrangement must be in the nature of a trust. This test is not satisfied if the scheme is merely a partnership, a syndicate, or a joint venture. Where a club is formed and the members manage and control the club directly without the intervention of a trustee, it is essentially the same as a partnership or joint venture. It is neither in form, nor in nature, a trust. This is not negated through a rule enabling securities to be held in the name of two or three members as trustees for the club. These persons are custodians and do not, by virtue of their appointment, manage and control the club. Control remains directly with the members even though it may be exercised through officers or a committee vested with authority.

Unit trusts that meet certain criteria are able to elect to become portfolio investment entities (PIEs) [see 1130 PORTFOLIO INVESTMENT ENTITIES].

1450.20 Public unit trusts
Many of the provisions contained in the ITA 2007 which deal specifically with unit trusts differentiate between those which are “public unit trusts” and those which are not. A public unit trust generally will be a
unit trust which is widely held (ie have 100 or more unit holders). However, there are some exceptions to this general rule.

The term “public unit trust” includes unit trusts that meet defined criteria. In order for a unit trust to be a public unit trust, it must fit within one of three broad categories:

(a) Unit trusts which have at least 100 unit holders;
(b) Unit trusts that are held by other institutions; or
(c) Unit trusts which have less than 100 investors, but which meet other criteria.

(1) At least one hundred unit holders

The first category of public unit trust refers mainly to public unit trusts. All of the following criteria must be met:

(a) The unit trust offers securities to the public in accordance with the Securities Act 1978;
(b) The unit trust has 100 or more unit holders; and
(c) The unit trust’s unit holders are:
   (i) Unit trust managers who hold units in the ordinary course of the manager’s activities in respect of the unit trust;
   (ii) Persons with an interest of 25 per cent or less in the unit trust; or
   (iii) Persons with an interest of 25 per cent or more provided that the person’s interest is 25 per cent or more due to unusual or temporary circumstances, such as the recent establishment or forthcoming termination of the public unit trust.

(2) Unit trusts held by other institutions

The second category refers mainly to unit trusts whose unit holders are any one or more of the following:

(a) A public unit trust within the meaning of one of the other categories;
(b) A group investment fund;
(c) A life insurance company;
(d) A superannuation fund;
(e) A unit trust manager, a trustee, or a person nominated by the manager or the trustee, who holds units in the ordinary course of the management activities in relation to the unit trust;
(f) A person with an interest of 25 per cent or less in the unit trust if the unit trust is one that offers securities to the public in accordance with the Securities Act 1978; or
(g) A person with an interest of 25 per cent or more if:
   (i) The person’s interest is 25 per cent or more due to unusual or temporary circumstances such as the recent establishment or forthcoming termination of the unit trust, being a unit trust that falls within one of the other categories of public unit trust; and
   (ii) The unit trust is one that offers securities to the public in accordance with the Securities Act 1978.

(3) Unit trusts with less than 100 unit holders

The third category refers to unit trusts which have less than 100 investors, but which meet the following specified criteria:

(a) The unit trust could reasonably be regarded as a widely-held investment vehicle for direct investment by members of the public despite the lesser number of unit holders or investors;
(b) The existence of less than 100 unit holders or investors is due to unusual or temporary circumstances, such as the recent establishment or forthcoming termination of the unit trust, being a unit trust that otherwise would be a public unit trust; or
(c) The unit trust could reasonably be regarded as a vehicle primarily for investment by widely-held vehicles for direct investment, being unit trusts, group investment funds, life insurance companies or superannuation funds.

(4) **Number of unit holders**

When counting the number of unit holders, all persons associated with each other are treated as being one person. To make this counting possible, the trustee is entitled to request the unit holders to disclose their associations. The unit holders are required to comply with the request and the trustee is entitled to rely on the disclosures unless there are reasonable grounds for believing that the disclosure is not correct.

**1450.30 Expenditure of member funds** [ss DV 5, DV 6, DV 7, IA 2(4), IA 7(4)]

It is common for a unit trust (a member fund) to invest in another unit trust (a master fund). The member fund may incur deductible expenditure but earn income only in the form of fully imputed dividends from the master fund. Where this occurs, the member fund will have insufficient net income to fully utilise the imputation credits. The legislative solution is as follows:

(1) **Expenditure of the member fund**

(a) Where the member fund incurs expenditure that is deductible under s DA 1 (the general permission), that expenditure can be transferred to the master fund.

(b) Expenditure that is either:
   
   (i) Revenue account property; or
   
   (ii) Expenditure on a financial arrangement, other than a financial arrangement that is denominated in New Zealand dollars and for which expenditure is allocated using the yield to maturity method,

   cannot be transferred.

(c) The member fund can transfer expenditure only to the extent to which it has a net loss.

(d) The member fund and the master fund must agree that the expenditure incurred by the member fund be transferred.

(e) If the member fund is a group investment fund that derives category A income, only expenditure that relates to the category A income may be transferred.

(f) The expenditure is treated as if it were expenditure incurred by the master fund in deriving its gross income in the income year in which the expenditure is transferred by the member fund.

(g) The expenditure is treated as not having been incurred by the member fund.

(h) Where the member fund incurs more expenditure than both funds agree can be transferred, the member fund can carry that expenditure forward for transfer in a later income year.

(i) Any expenditure carried forward by the member fund can be treated as a “tax loss component”. A tax loss component is able to be carried forward to the next income year.

(j) In the income year in which the member fund ceases to invest in the master fund, neither the member fund nor the master fund may deduct expenditure that would otherwise be transferable, and the member fund must treat the expenditure as a tax loss component.

(2) **Deduction to the master fund**

(a) The maximum amount of expenditure that may be transferred to a master fund is the amount of the master fund’s taxable income for the year minus the total of its non-resident withholding income of the kinds to which s RF 2(5), (6) apply (where the NRWT is a minimum tax), derived in the year when the expenditure was incurred.

(b) A master fund that is a group investment fund that derives category A income may deduct expenditure only in respect of its category A income.
(c) If the master fund has filed its return of income and then finds that it is able to deduct more that was deducted in its return, the CIR has the power to allow the member fund to transfer additional expenditure to the master fund.

(d) The transfer provisions are available only where the member fund has some or all of its funds invested in the master fund at all times from the time at which the expenditure was incurred to the end of the income year in which the master fund is seeking a deduction for that expenditure.

1450.40 Measurements of interests for the continuity provisions [s YC 12]

The unit holders of a “public unit trust”, in their collective capacity are treated as holding all shares in the public unit trust as if they were always the same notional single person that is not a company, exists while the unit trust exists and holds nothing but the shares in the unit trust.

1450.50 Disclosure requirements for the purposes of the continuity provisions [TAA, s 32D]

For the purposes of the continuity provisions, the trustee of a public unit trust can require unit holders to provide the trustee with a written statement of persons associated with the shareholder. The request must be in writing.

Upon receipt of such a request, the unit holder has 20 working days in which to provide the statement. The trustee is entitled to rely on the statement as being correct unless the trustee has reasonable grounds for believing that the statement is not correct.

1450.60 Redemption of units [s CD 16]

From 1 April 1996, units in a unit trust on issue as at that date are treated as not having been issued on terms that their redemption would be subject to the slice rule. However, a unit trust manager may elect out of this provision. [s CZ 13].

Special imputation rules apply where:

(a) Fund A unit trust manager which derives category A income acquires units from a unit holder; and

(b) Those units are acquired in the ordinary course of the trustee’s or manager’s activities in respect of the unit trust and in accordance with the issue terms of the units.

Under these circumstances, the dividend derived by the manager or trustee does not include the amount of any imputation credit or dividend withholding credit attached to the dividend to the extent to which the dividend, exclusive of the credit, exceeds the amount paid by the manager to acquire the units. The measure was introduced to preclude the double claiming of credits.

1450.70 Imputation [ss OB 45, OP 45]

A special imputation debit may arise to the ICA of a unit trust manager or the trustee or manager of a Group Investment Fund (GIF). The debit arises where the manager or trustee derives a dividend on redeeming units purchased from investors in the ordinary course of the manager’s or trustee’s activities. The debit is effectively an amount equal to the greater of the total imputation and DWP credits attached to the dividend or the amount of income tax liability of the manager or trustee that is attributable to the dividend [see TIB vol 7:9 (February 1996) at 7].
APPENDICES
# Chapter 2000

## Tax Calendar

### 2000.10  Tax calendar (2012-2013)

The schedule below sets out important due dates for tax returns and payments for the year ending 31 March 2013. The following points should be noted:

- Tax payments must be made on or before the due date. If the due date falls on a weekend or a public holiday, the payment is due on the next working day [see 1100.13].
- A “large employer”, for PAYE purposes, is one whose PAYE deductions for the previous year were $500,000 or more [see 1080.81]. A “small employer” is an employer whose annual PAYE deductions are less than $500,000.
- PAYE tax deductions falling due for payment on a particular date include any ESCT, earner levy, student loan repayments, child support, or KiwiSaver deductions relating to the relevant period.
- The approved issuer levy is paid by approved issuers in relation to interest payments made to non-residents [see 1020.80].

**Note:** The due dates in the following schedule are the effective due dates, adjusted as necessary where the statutory due date falls on a weekend or public holiday. If the effective due date is not the same as the statutory due date, the statutory due date is shown in brackets.

#### 2012

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 April</td>
<td>Large employers — PAYE deductions for 16-31 March 2012, employer deductions form, and employer monthly schedule for March 2012.</td>
</tr>
<tr>
<td>9 April</td>
<td>Terminal tax for taxpayers (with a tax agent) with balance dates between 1 March and 30 September 2011.</td>
</tr>
<tr>
<td>30 April</td>
<td>GST return and payment for the period ended 31 March 2012.</td>
</tr>
<tr>
<td>Date</td>
<td>Event Description</td>
</tr>
<tr>
<td>------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>21 May</td>
<td>Large employers — PAYE deductions for 1-15 May 2012 and employer deductions form. Small employers — PAYE deductions for all of April 2012, employer deductions form, and employer monthly schedule for April 2012. NRWT deducted during April 2012 for monthly payers. Approved issuer levy for interest payments made in April 2012. RWT deducted from interest during April 2012, for monthly payers. RWT deducted from dividends and taxable Maori authority distributions during April 2012. RWT deduction certificates (IR15) to be delivered to recipients of interest or dividends for deductions for the year ended 31 March 2012 [see 1260.110].</td>
</tr>
<tr>
<td>28 May</td>
<td>GST return and payment for the period ended 30 April 2012. Provisional tax [see 2000.20].</td>
</tr>
<tr>
<td>31 May</td>
<td>RWT annual reconciliation statements for year ended 31 March 2012. FBT return and payment for quarter ended 31 March 2012. FBT return and payment when paid on an annual basis for year ended 31 March 2012. (The due date for the FBT return and payment when paid on an income year basis for shareholder-employees is the final date for payment of terminal tax.) FBT nil return for employers who provide no fringe benefits for year ended 31 March 2012. NRWT annual reconciliation statement and deduction certificates for year ended 31 March 2012.</td>
</tr>
<tr>
<td>28 June</td>
<td>GST return and payment for the period ended 31 May 2012. Provisional tax [see 2000.20].</td>
</tr>
<tr>
<td>2 July</td>
<td>Last day for small employers to elect to pay FBT annually.</td>
</tr>
<tr>
<td>5 July</td>
<td>Large employers — PAYE deductions for 16-30 June 2012, employer deductions form, and employer monthly schedule for June 2012.</td>
</tr>
</tbody>
</table>
9 July
Annual income tax returns (2011-2012) for taxpayers with balance dates between 1 October 2011 and 31 March 2012.
Annual imputation returns for taxpayers with balance dates between 1 October 2011 and 31 March 2012.
Company dividend statements for balance dates between 1 October 2011 and 31 March 2012.
Maori authority credit account returns for balance dates between 1 October 2011 and 31 March 2012.

20 July
Large employers — PAYE deductions for 1-15 July 2012 and employer deductions form.
Small employers — PAYE deductions for all of June 2012, employer deductions form, and employer monthly schedule for June 2012.
NRWT deducted during June 2012 for monthly payers.
Approved issuer levy for interest payments made in June 2012.
RWT deducted from interest during June 2012, for monthly payers.
RWT deducted from dividends and taxable Maori authority distributions during June 2012.
FBT return and payment for quarter ended 30 June 2012.

30 July
GST return and payment for period ended 30 June 2012.

31 July
Annual ICA return for year ended 31 March 2012 for Australian ICA companies not required to file New Zealand returns of income.

6 August

7 August
Annual income tax returns for taxpayers with April 2012 balance dates.
Annual imputation, BETA, policyholder credit account, Maori authority credit account returns, and company dividend statement for taxpayers with April 2012 balance dates.

20 August
Large employers — PAYE deductions for 1-15 August 2012 and employer deductions form.
NRWT deducted during July 2012 for monthly payers.
Approved issuer levy for interest payments made in July 2012.
RWT deducted from interest during July 2012, for monthly payers.
RWT deducted from dividends and taxable Maori authority distributions during July 2012.

28 August
GST return and payment for period ended 31 July 2012.
Provisional tax [see 2000.20].

5 September
Large employers — PAYE deductions for 16-31 August 2012, employer deductions form, and employer monthly schedule for August 2012.
7 September
- Terminal tax (October 2011 balance dates).
- Terminal student loan repayment (October balance dates).
- QCET and interest for companies with October balance dates that become QCs for the 2011-2012 income year.
- Annual income tax returns for taxpayers with May 2012 balance dates.
- Annual imputation, BETA, policyholder credit account, Maori authority credit account returns, and company dividend statement for taxpayers with May 2012 balance dates.
- FBT return and payment for employers with October 2011 balance date paying on income year basis.

20 September
- Large employers — PAYE deductions for 1-15 September 2012 and employer deductions form.
- NRWT deducted during August 2012 for monthly payers.
- Approved issuer levy for interest payments made in August 2012.
- RWT deducted from interest during August 2012, for monthly payers.
- RWT deducted from dividends and taxable Maori authority distributions during August 2012.

28 September
- GST return and payment for period ended 31 August 2012.
- Provisional tax [see 2000.20].

30 September
- Second instalment of 2012-2013 non-resident student loan repayments.

5 October

8 October
- Terminal tax (November 2011 balance dates).
- Terminal student loan repayment (November 2011 balance dates).
- QCET and interest for companies with November balance dates that become QCs for the 2011-2012 income year.
- Annual income tax returns for taxpayers with June 2012 balance dates.
- Annual imputation, BETA, policyholder credit account, Maori authority credit account returns, and company dividend statement for taxpayers with June 2012 balance dates.
- FBT return and payment for employers with November 2011 balance date paying on income year basis.

22 October
- Large employers — PAYE deductions for 1-15 October 2012 and employer deductions form.
- Small employers — PAYE deductions for all of September 2012, employer deductions form, and employer monthly schedule for September 2012.
- NRWT deducted during September 2012 for monthly payers.
- NRWT deducted 1 April 2012 to 30 September 2012 for six-monthly payers.
- Approved issuer levy for interest payments made in September 2012.
RWT deducted from interest during September 2012, for monthly payers.
RWT deducted from interest 1 April 2012 to 30 September 2012, for six-monthly payers.
RWT deducted from dividends and taxable Maori authority distributions during September 2012.

FBT return and payment for quarter ended 30 September 2012.

29 October
GST return and payment for period ended 30 September 2012.

Provisional tax [see 2000.20].

5 November

7 November
Terminal tax (December 2011 balance date).
Terminal tax (October 2011 balance date and with tax agent).
Terminal student loan repayment (December 2011 balance dates).
QCET and interest for companies with December balance dates that become QCs for the 2011-2012 income year.
Annual income tax returns for taxpayers with July 2012 balance dates.
Annual imputation, BETA, policyholder credit account, Maori authority credit account returns, and company dividend statement for taxpayers with July 2012 balance dates.
FBT return and payment for employers with December 2011 balance date paying on income year basis.

20 November
Large employers — PAYE deductions for 1-15 November 2012 and employer deductions form.
NRWT deducted during October 2012 for monthly payers.
Approved issuer levy for interest payments made in October 2012.
RWT deducted from interest during October 2012, for monthly payers.
RWT deducted from dividends and taxable Maori authority distributions during October 2012.

28 November
GST return and payment for period ended 31 October 2012.
Provisional tax [see 2000.20].

5 December

7 December
Terminal tax (January 2012 balance date).
Terminal tax (November 2012 balance date and with tax agent).
Terminal student loan repayment (January 2012 balance dates).
QCET and interest for companies with January balance dates that become QCs for the 2011-2012 income year.
Annual income tax returns for taxpayers with August 2012 balance dates.
Annual imputation, BETA, policyholder credit account, Maori authority credit account returns, and company dividend statement for taxpayers with August 2012 balance dates.

FBT return and payment for employers with January 2012 balance date paying on income year basis.

**20 December**

Large employers — PAYE deductions for 1-15 December 2012 and employer deductions form.


NRWT deducted during November 2012 for monthly payers.

Approved issuer levy for interest payments made in November 2012.

RWT deducted from interest during November 2012, for monthly payers.

RWT deducted from dividends and taxable Maori authority distributions during November 2012.

Third instalment of 2012-2013 non-resident student loan repayments.

**2013**

**7 January**

Annual income tax returns for taxpayers with September 2012 balance dates.

Annual imputation, BETA, policyholder credit account, Maori authority credit account returns, and company dividend statement for taxpayers with September 2012 balance dates.

**15 January**


Provisional tax [see 2000.20].

Terminal tax (February 2012 balance date).

Terminal tax (December 2011 balance date and with tax agent).

Terminal student loan repayment (February 2012 balance dates).

QCET and interest for companies with February balance dates that become QCs for the 2011-2012 income year.

FBT return and payment for employers with February 2012 balance date paying on income year basis.

GST return and payment for period ended 30 November 2012.

**21 January**

Large employers — PAYE deductions for 1-15 January 2013 and employer deductions form.


NRWT deducted during December 2012 for monthly payers.

Approved issuer levy for interest payments made in December 2012.

RWT deducted from interest during December 2012, for monthly payers.

RWT deducted from dividends and taxable Maori authority distributions during December 2012.

FBT return and payment for quarter ended 31 December 2012.

**28 January**

GST return and payment for period ended 31 December 2012.
Provisional tax [see 2000.20].

5 February  

7 February  
Terminal tax for taxpayers (without tax agents) with balance dates between 1 March and 30 September 2012.
Terminal tax (January 2012 balance date and with tax agent).
Terminal student loan repayment (balance dates between 1 March and 30 September 2012).
QCET and interest for companies with balance dates between 1 March and 30 September 2012 that become QCs for the 2012-2013 income year.
FBT return and payment for employers with balance dates between 1 March and 30 September 2012, paying on income year basis.

20 February  
Large employers — PAYE deductions for 1-15 February 2013 and employer deductions form.
NRWT deducted during January 2013 for monthly payers.
Approved issuer levy for interest payments made in January 2013.
RWT deducted from interest during January 2013, for monthly payers.
RWT deducted from dividends and taxable Maori authority distributions during January 2013.

28 February  
GST return and payment for period ended 31 January 2013.
Provisional tax [see 2000.20].

5 March  

7 March  
Terminal tax (February 2012 balance date and with tax agent).

20 March  
Large employers — PAYE deductions for 1-15 March 2013 and employer deductions form.
NRWT deducted during February 2013 for monthly payers.
Approved issuer levy for interest payments made in February 2013.
RWT deducted from interest during February 2013, for monthly payers.
RWT deducted from dividends and taxable Maori authority distributions during February 2013.

28 March  
GST return and payment for period ended 28 February 2013.
Provisional tax [see 2000.20].

1 April (or [31 March])  
Annual income tax returns for the year ended 31 March 2012 for taxpayers (with a tax agent) with balance dates between 1 October 2011 and 31 March 2012.
Fourth instalment of 2012-2013 non-resident student loan repayments.
ICA balance must be nil or in credit at close of business, or 10 per cent imputation penalty incurred [see 670.105].
### Provisional tax calendar (2012-2013)

For commentary on the provisional tax rules see 1150 PROVISIONAL AND TERMINAL TAX.

<table>
<thead>
<tr>
<th>Due date</th>
<th>Provisional taxpayers not registered for GST, or registered on a 1- or 2-month basis</th>
<th>Provisional taxpayers registered for GST on a 6-month basis</th>
<th>Provisional taxpayers registered for GST and using the GST ratio method</th>
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<tr>
<td><strong>2012</strong></td>
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<td>January 2013 balance date: instalment 1.</td>
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<td>Provisional taxpayers registered for GST on a 6-month basis</td>
<td>Provisional taxpayers registered for GST and using the GST ratio method</td>
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### Tax Calendar

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<th>Provisional taxpayers not registered for GST, or registered on a 1- or 2-month basis</th>
<th>Provisional taxpayers registered for GST on a 6-month basis</th>
<th>Provisional taxpayers registered for GST and using the GST ratio method</th>
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<td>May 2013 balance date: instalment 2.</td>
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<td>July 2013 balance date: instalment 1.</td>
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<td></td>
<td>April 2013 balance date: instalment 3.</td>
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<td></td>
<td></td>
<td>June 2013 balance date: instalment 2.</td>
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<td>August 2013 balance date: instalment 1.</td>
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<tr>
<td>2013</td>
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<td></td>
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<td>May 2013 balance date: instalment 3.</td>
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<td>July 2013 balance date: instalment 2.</td>
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<td></td>
<td>September 2013 balance date: instalment 1.</td>
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<td>Due date</td>
<td>Provisional taxpayers not registered for GST, or registered on a 1- or 2-month basis</td>
<td>Provisional taxpayers registered for GST on a 6-month basis</td>
<td>Provisional taxpayers registered for GST and using the GST ratio method</td>
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<td>August 2013 balance date: instalment 3.</td>
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<td>October 2013 balance date: instalment 2.</td>
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<td></td>
<td>December 2013 balance date: instalment 1.</td>
</tr>
</tbody>
</table>
# Chapter 3000

## Binding Rulings

### 3000.10 Public rulings

The following public rulings are active. The list also includes rulings cited in *Staples Tax Guide*.

<table>
<thead>
<tr>
<th>Number</th>
<th>Title</th>
<th>Effective dates</th>
<th>Staples paragraph</th>
</tr>
</thead>
<tbody>
<tr>
<td>BR Pub 05/01</td>
<td>Bad debts — writing-off debts as bad for GST and income tax purposes.</td>
<td>From 1/4/04</td>
<td>90.50</td>
</tr>
<tr>
<td>BR Pub 05/02</td>
<td>Disposition of real property for inadequate consideration (grant of a life estate).</td>
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<td>Payments made by parents or guardians of students to state schools — GST treatment</td>
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<td>Fishing quota — secondhand goods input tax credits.</td>
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<td>Coastal permits and certificates of compliance — secondhand goods input tax credits.</td>
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<td>Lease surrender payments received by a landlord — income tax treatment.</td>
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<td>Distributions made by Australian unit trust to Australian limited partnership and foreign tax credits.</td>
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<td>BR Pub 10/04</td>
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<td>Tax paid by an Australian limited partnership as a “head company” and foreign tax credits.</td>
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<td>Meaning of “anything occurring on liquidation” when a company requests removal from the Register of Companies.</td>
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<td>Commissions received by life agents on their own policies and those of associated persons — income implications.</td>
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<td>Legal services provided to non-residents relating to transactions involving land in New Zealand.</td>
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<td>Local authority rates apportionments on property transactions where the rates have been paid beyond settlement - Goods and Services Tax implications for vendor.</td>
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<td>BR Pub 10/12</td>
<td>Local authority rates apportionments on property transactions where the rates are in arrears - Goods and Services Tax implications for vendor.</td>
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<td>Local authority rates apportionments on property transactions where the rates are in arrears - Goods and Services Tax implications for purchaser.</td>
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<td>Interest deductibility - funds borrowed by a partnership to return capital contributions.</td>
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<td>Interest deductibility - funds borrowed by a partnership to return profits.</td>
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<td>Interest deductibility - funds borrowed by a company to repurchase shares.</td>
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<td>Interest deductibility - funds borrowed by a company to pay dividends contributions.</td>
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<td>Interest deductibility - funds borrowed to repay debt.</td>
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<td>Interest deductibility - funds borrowed make a payment to a group company.</td>
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Chapter 4000
Charities List

4000.10 Publication of Charities List

Staples Tax Guide no longer includes a list of the institutions and funds recognised by Inland Revenue as donees qualifying for the charitable gifts and donation tax credits. Similarly, Staples Tax Guide no longer includes a list of entities whose donee status has ceased and which are no longer registered as charities.

The full list of charitable organisations with donee status - including those with ceased donee status - is available at Inland Revenue’s website, at www.ird.govt.nz/donee-organisations/. This searchable list is updated continuously and can be viewed in its entirety in spreadsheet form.

Alternatively, the Charities Commission also provides a comprehensive means of searching for any particular registered charity (ie which has donee status) at: www.register.charities.govt.nz/CharitiesRegister/Search.aspx. The search of the Charities Commission Register can be undertaken by reference to the organisation’s name or part thereof; addresses; activities undertaken; officers; beneficiaries; and registration number.

Once a search is complete, the results provide all details relevant to the particular charity. These details include the name of the charity; date of registration; addresses; beneficiaries; charitable purposes; supporting documents; area of operation; officers; annual returns; and any exemptions applying to the organisation.

The Charities Commission Register also maintains records for entities which have ceased to be registered and which no longer have donee status for tax purposes. All details are included for organisations which have been de-registered, including the date of and reasons for, de-registration.
**Chapter 5000**

**Depreciation Rates**

5000.10 Economic depreciation rates

5000.20 Depreciation rates (assets acquired from 1 April 2005) — industry categories

5000.30 Depreciation rates (assets acquired from 1 April 2005) — asset categories

5000.40 Amortisation rates for listed horticultural plants

### 5000.10 Economic depreciation rates

**How the Schedules Work**

The economic depreciation rates are set out in the following schedules:

(a) Industry category — for assets acquired from 1 April 2005 [see 5000.20]; and

(b) Asset category — for assets acquired from 1 April 2005 [see 5000.30].

The rates including the 20 per cent loading (shown in the schedules in the columns headed “DV+20%” and “SL+20%”) apply only to assets acquired before 21 May 2010 [see 250.270]. The 20 per cent loading does not apply to buildings and certain other assets.

To select the appropriate depreciation rate from the schedules of economic depreciation rates in 5000.20 and 5000.30, follow the procedure set out in the following flowchart.

For assets acquired before 1 April 2005 (19 May 2005 in the case of buildings), see *Staples Tax Guide (2008) 6000 OLD AND HISTORIC DEPRECIATION RATES* (Online and CD only).

When an asset is peculiar to a specific industry, it is listed under the relevant industry category. The industry categories (and the assets within them) are alphabetically listed. When an asset is typically used in a variety of different industries, it is listed under the asset category in alphabetical order. Some assets are listed within...
two or more industry categories. In some cases the depreciation rate is the same, and in other cases the
depreciation rates are different, which reflects the different industrial environment in which each is used.

(2) Definitions of terms used in depreciation rates

“Gross vehicle mass” is the greater of the gross vehicle mass of the vehicle as specified by the vehicle’s
manufacturer and that specified by the Director of Land Transport Safety. Refer to the LTSA website for
further information.

(3) Industry categories

- Agriculture, horticulture, and aquaculture
- Audio and video recording studios, and professional photography
- Bakeries
- Battery manufacturing
- Brewing, winemaking, and distilleries
- Cable making
- Cement manufacturing
- Chemical plant (including soap, detergent, paint, glue, starch, colour, personal products, and fertiliser)
- Cigarette manufacturing
- Cleaning, refuse and recycling
- Concrete and plaster
- Contractors, builders, and quarrying
- Dairy plant
- Electrical and electronic engineering (for test equipment, see also “scientific, medical, and laboratory”)
- Engineering (including automotive)
- Fishing (see also “meat and fish processing”)
- Food processing
- Footwear manufacturing
- Glass works and moulding
- Hotels, motels, restaurants, cafes, taverns, and takeaway bars
- Laundry
- Leisure
- Manufacturers (not elsewhere specified)
- Meat and fish processing
- Medical and medical laboratory equipment
- Metal industries (primary) and foundries
- Milling (including grain handling and seed cleaning)
- Mining (see also “contractors, builders, and quarrying”)
- Oil and gas industry
- Packaging (excluding plastic packaging)
- Pharmaceuticals
- Plastics
- Pottery, tile and brick making
- Power generation and electrical reticulation systems
- Printing and photographic
- Pulp and paper manufacturing
- Residential rental property chattels
- Rubber and tyre manufacturing
- Shops (retail and wholesalers)
- Tanning and fellmongering
- Telecommunications
- Textile, garment and carpet manufacturing
Depreciation Rates

- Timber and joinery industries
- Undersea maintenance (where equipment used under salt water or on maintenance barge on salt water) (from 1997 year)

4. Asset categories

- Boilers and heaters (where not industry specified)
- Books, music, and manuscripts
- Buildings and structures
- Building fit-out (where in books separately from building cost)
- Clothing
- Compressed air plant (where not industry specified)
- Computers
- Factory and other sundries
- Hire equipment
- Hire equipment (where on short term hire of one month or less only)
- Lifting
- Office equipment and furniture
- Pumping sets (where not industry specified)
- Refrigeration
- Reticulation systems including power generation
- Scientific and laboratory equipment (excluding equipment used in a medical laboratory)
- Software
- Tanks, vats, and reservoirs (where not industry specified)
- Transportation
- Water and effluent treatment
- Weighing machines (where not industry specified)

5000.20 Depreciation rates (assets acquired from 1 April 2005) — industry categories

<table>
<thead>
<tr>
<th>Industry Categories</th>
<th>EUL</th>
<th>DV%</th>
<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
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<tr>
<td><strong>Agriculture, horticulture, and aquaculture</strong></td>
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<td>Agricultural and horticultural machinery (not specified)</td>
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<td>15.6</td>
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<td>Aeroplanes (top dressing and spraying) and specialised attachments</td>
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<td>Bush cutters</td>
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<td>Chainsaws</td>
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<td>Cherry pickers</td>
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<td>Cleaning machinery</td>
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<td>Compressor (refrigerant) [acquired on or after 14 September 2005]</td>
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<td>Crates (pig)</td>
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## Depreciation Rates

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<th>DV+20%</th>
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<td>Cultivators (rotary)</td>
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<td>48</td>
<td>30</td>
<td>36</td>
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<td>Dairy shed and yard (including pipe work, bailings and gates) [acquired on or after 14 September 2005]</td>
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<td>67</td>
<td>80.4</td>
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<td>Equestrian arena, consisting of permanent construction materials (excluding the base course) [provisional rate; applies from the 2010-2011 income year]</td>
<td>12.5</td>
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<td>19.2</td>
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<td>12.6</td>
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<td>Graders (tomatoes)</td>
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<td>15.6</td>
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<td>16</td>
<td>19.2</td>
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<td>Hi-trim shelter trimmer (including sub-frame)</td>
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### Depreciation Rates

**Industry Categories**

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Staples Tax Guide 2012
### Depreciation Rates

#### Industry Categories

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<th>DV+20%</th>
<th>SL%</th>
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#### Bakeries

Staples Tax Guide 2012
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<th>SL%</th>
<th>SL+20%</th>
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### Battery manufacturing

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<th>DV+20%</th>
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#### Brewing, winemaking, and distilleries

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## Depreciation Rates

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### Cement manufacturing

- Cement manufacturing plant and equipment (not specified)
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</table>
- Blowers
  |                        | 10  | 20  | 24     | 13.5| 16.2   |
- Blowlines
  |                        | 20  | 10  | 12     | 7   | 8.4    |
- Conveyors
  |                        | 20  | 10  | 12     | 7   | 8.4    |
- Kilns (lime)
  |                        | 25  | 8   | 9.6    | 6   | 7.2    |
- Kilns (rotary) and associated equipment
  |                        | 25  | 8   | 9.6    | 6   | 7.2    |
- Kilns (vertical) and associated equipment
  |                        | 25  | 8   | 9.6    | 6   | 7.2    |
- Mills (ball)
  |                        | 25  | 8   | 9.6    | 6   | 7.2    |
- Mills (roller)
  |                        | 25  | 8   | 9.6    | 6   | 7.2    |
- Mixing plant
  |                        | 20  | 10  | 12     | 7   | 8.4    |
- Packing plant
  |                        | 20  | 10  | 12     | 7   | 8.4    |
- Silos (concrete)
  |                        | 50  | 4   | 4.8    | 3   | 3.6    |
- Tanks (concrete)
  |                        | 50  | 4   | 4.8    | 3   | 3.6    |

### Chemical plant (including soap and detergent, paint, glue, starch, colour, personal products, and fertiliser)

- Chemical plant and machinery (not specified)
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</table>
- Blowers
  |                        | 12.5| 16  | 19.2   | 10.5| 12.6   |
- Blowing towers
  |                        | 25  | 8   | 9.6    | 6   | 7.2    |
- Canister manufacturing machines
  |                        | 12.5| 16  | 19.2   | 10.5| 12.6   |
- Capping machines
  |                        | 15.5| 13  | 15.6   | 8.5 | 10.2   |
- Carton closing machines
  |                        | 15.5| 13  | 15.6   | 8.5 | 10.2   |
- Charges (ball mill)
  |                        | 3   | 67  | 80.4   | 67  | 80.4   |

Staples Tax Guide 2012
## Industry Categories

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<tr>
<th>Industry Categories</th>
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**Cigarette manufacturing**

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### Industry Categories

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<td>Bins (for glass)</td>
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<tr>
<td>Bins (metal, rubbish)</td>
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<tr>
<td>Bins (recycling plastic)</td>
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<td>Bins (rubbish)</td>
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<td>Scrubbers (floor)</td>
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<td>Shredding plant (wastepaper)</td>
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<td>Skips (metal, rubbish)</td>
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<td>Sweepers (trucks for street, etc)</td>
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### Concrete and plaster

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Staples Tax Guide 2012
### Depreciation Rates

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**Contractors, builders, and quarrying**

<p>| Contractors, builders and quarrying plant and equipment (default class) | 15.5 | 13  | 15.6 | 8.5 | 10.2   |
| Backactors                                                             | 15.5 | 13  | 15.6 | 8.5 | 10.2   |
| Bitumen laying equipment                                               | 12.5 | 16  | 19.2 | 10.5| 12.6   |
| Borers                                                                 | 15.5 | 13  | 15.6 | 8.5 | 10.2   |
| Breakers                                                                | 5    | 40  | 48   | 30  | 36     |
| Brush cutters                                                          | 5    | 40  | 48   | 30  | 36     |
| Builders’ planks (wooden) (other than those used as part of scaffolding) | 3    | 67  | 80.4 | 67  | 80.4   |</p>
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**Dairy plant**

| Dairy plant and equipment (not specified) | 15.5 | 13 | 15.6 | 8.5 | 10.2 |
| Blending bins (casein)                   | 15.5 | 13 | 15.6 | 8.5 | 10.2 |
| Butter making machines (except as specified) | 15.5 | 13 | 15.6 | 8.5 | 10.2 |
| Butter patting machines                  | 12.5 | 16 | 19.2 | 10.5 | 12.6 |
| Centrifuges                              | 15.5 | 13 | 15.6 | 8.5 | 10.2 |
| Cheddaring system                        | 12.5 | 16 | 19.2 | 10.5 | 12.6 |
| Cheese maturing boards                   | 6.66 | 30 | 36   | 21   | 25.2 |
| Cheese plant                             | 15.5 | 13 | 15.6 | 8.5 | 10.2 |
| Churns                                   | 15.5 | 13 | 15.6 | 8.5 | 10.2 |
| Clarifiers (whey)                         | 15.5 | 13 | 15.6 | 8.5 | 10.2 |
| Compressor (refrigerant, on farm)        | 12.5 | 16 | 19.2 | 10.5 | 12.6 |

Staples Tax Guide 2012
## Depreciation Rates

<table>
<thead>
<tr>
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<th>EUL</th>
<th>DV%</th>
<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
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## Depreciation Rates

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**Electrical and electronic engineering equipment (see also Medical and laboratory equipment, Scientific and laboratory equipment)**

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## Depreciation Rates

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**Engineering (including automotive)**

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* These rates apply to cylinders acquired on or after 1 October 1996. For cylinders acquired before that date, the following rate applies:

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Staples Tax Guide 2012
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### Depreciation Rates

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#### Footwear manufacturing

Footwear manufacturing machinery (not specified) | 15.5 | 13  | 15.6 | 8.5 | 10.2 |
Attaching machines                             | 15.5 | 13  | 15.6 | 8.5 | 10.2 |
Benches                                      | 15.5 | 13  | 15.6 | 8.5 | 10.2 |
Blocking machines                              | 15.5 | 13  | 15.6 | 8.5 | 10.2 |
Brushing machines                              | 15.5 | 13  | 15.6 | 8.5 | 10.2 |
Cementing machines                            | 12.5 | 16  | 19.2 | 10.5| 12.6 |
Cutting machines (for circles)                | 15.5 | 13  | 15.6 | 8.5 | 10.2 |
Dust collectors                               | 8    | 25  | 30    | 17.5| 21    |
Edge setting machines                         | 15.5 | 13  | 15.6 | 8.5 | 10.2 |
Eyeletting machines                           | 12.5 | 16  | 19.2 | 10.5| 12.6 |
Finishing machines                            | 15.5 | 13  | 15.6 | 8.5 | 10.2 |
Folding machines                              | 15.5 | 13  | 15.6 | 8.5 | 10.2 |
Footwear manufacturing machinery (micro-processor controlled) | 8    | 25  | 30    | 17.5| 21    |
Gluing machines                               | 12.5 | 16  | 19.2 | 10.5| 12.6 |
Grading machines (patterns)                   | 12.5 | 16  | 19.2 | 10.5| 12.6 |
Knives                                       | 2    | 100 | 100   | 100 | 100   |
Lacing machines                               | 15.5 | 13  | 15.6 | 8.5 | 10.2 |
Lasting machines (electro/pneumatic or hydraulic) | 10  | 20  | 24    | 13.5| 16.2 |
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### Hotels, motels, restaurants, cafes, taverns, and takeaway bars

Hotel, motel, restaurant, cafe, tavern and takeaway bar equipment and machinery (not specified)  
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Appliances (domestic type)  
6.66  30  36  21  25.2  
Bain mares  
12.5  16  19.2  10.5  12.6  
Bedding  
3  67  80.4  67  80.4  
Beds  
10  20  24  13.5  16.2  
Beer systems  
12.5  16  19.2  10.5  12.6  
Beer tanks  
20  10  12  7  8.4  
Benches  
20  10  12  7  8.4  
Blankets  
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<th>DV+20%</th>
<th>SL %</th>
<th>SL+20%</th>
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## Depreciation Rates

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* These rates apply to cylinders acquired on or after 1 October 1996. For cylinders acquired before that date, the following rate applies:

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Paintings and drawings, in either case being property the value of which might reasonably be expected in normal circumstances to decline in value:

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Staples Tax Guide 2012
## Depreciation Rates

### Industry Categories

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<td>Set-top boxes with hard drive and personal video recorders (PVRs) with hard drive — from 2005-2006 income year.</td>
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### Laundry

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Staples Tax Guide 2012
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<th>SL%</th>
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<th>SL%</th>
<th>SL+20%</th>
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### Depreciation Rates

**Industry Categories**

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*Manufacturers (not elsewhere specified)*
## Depreciation Rates

### Industry Categories

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### Meat and fish processing

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## Depreciation Rates

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### Medical and medical laboratory equipment (from 1995 year)

Medical, veterinary, dental, optical, chiropractors, funeral directors (excluding casket making machinery), and medical laboratory plant and equipment (default class)

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### Depreciation Rates

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Staples Tax Guide 2012
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## Depreciation Rates

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**Milling (including grain handling and seed cleaning)**

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# Depreciation Rates

## Industry Categories

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* These rates apply to cylinders acquired on or after 1 October 1996. For cylinders acquired before that date, the following rate applies:

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<table>
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## Packaging (excluding plastic packaging)

Staples Tax Guide 2012
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**Plastics**

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## Depreciation Rates

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### Pottery, tile and brick making

Pottery, tile and brick making plant and equipment (not specified)

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**Power generation and electrical reticulation systems**

Power generation and electrical reticulation (not specified) | 20 | 10 | 12 | 7 | 8.4 |
### Industry Categories

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### Depreciation Rates

#### Industry Categories

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#### Printing and photographic (see also Audio and video recording studios and professional photography)

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</table>

- Fully integrated digital machines that consist of scanner, image processor, printer-paper processor components in a single all-in-one machine; or
- Digital machines in which the scanner, image processor, and printer-paper processor components are not physically integrated into a single all-in-one machine but nevertheless operate as a matched composite unit;
- But does not include a separate film processor machine.
## Industry Categories

<table>
<thead>
<tr>
<th>Industry Categories</th>
<th>EUL</th>
<th>DV%</th>
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<th>SL%</th>
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### Depreciation Rates

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### Pulp and paper manufacturing

**Pulp and paper manufacturing plant and equipment (not specified)**

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## Depreciation Rates

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### Residential rental property chattels

(The following rates apply from 1 April 2011, to the 2011-12 and subsequent income years)

| Chattels (default class)              | 5   | 40  | 48     | 30  | 36     |
| Air conditioners and heat pumps (through wall or window type) | 10  | 20  | 24     | 13.5| 16.2   |
| Air ventilation systems               | 10  | 20  | 24     | 13.5| 16.2   |
| Alarms (burglar or smoke, wired or wireless) | 6.66| 30  | 36     | 21  | 25.2   |
| Appliances (small)                    | 4   | 50  | 60     | 40  | 48     |
| Awnings                               | 10  | 20  | 24     | 13.5| 16.2   |
| Bedding                               | 3   | 67  | 80.4   | 67  | 80.4   |
| Blinds                                | 8   | 25  | 30     | 17.5| 21     |
| Carpets                               | 8   | 25  | 30     | 17.5| 21     |
| Clotheslines                          | 8   | 25  | 30     | 17.5| 21     |
| Crockery                              | 3   | 67  | 80.4   | 67  | 80.4   |
| Curtains                              | 8   | 25  | 30     | 17.5| 21     |
| Cutlery                               | 3   | 67  | 80.4   | 67  | 80.4   |
## Depreciation Rates

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<th>SL%</th>
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### Rubber and tyre manufacturing

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### Depreciation Rates

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Staples Tax Guide 2012
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**Tanning and fellmongering**

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## Industry Categories

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### Telecommunications (see also Office equipment and furniture — Telephone systems)

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### Industry Categories

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### Textile, garment and carpet manufacturing

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### Timber and joinery industries

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## Depreciation Rates

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<tr>
<td>Log decks</td>
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<td>8.4</td>
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<tr>
<td>Log grabs (fork lift truck attachments)</td>
<td>12.5</td>
<td>16</td>
<td>19.2</td>
<td>10.5</td>
<td>12.6</td>
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### Depreciation Rates

#### Industry Categories

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<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
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<tbody>
<tr>
<td>Log splitter (manually operated)</td>
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<td>Log splitter (computerised)</td>
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<td>20</td>
<td>24</td>
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<td>Machine centre (computer numerically controlled)</td>
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<td>25</td>
<td>30</td>
<td>17.5</td>
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<td>Moisture meters</td>
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<td>Morticers</td>
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<td>15.6</td>
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<td>Tools (hand)</td>
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<td>80.4</td>
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<td>Tools (power, hand held)</td>
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<td>80.4</td>
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<td>Winches</td>
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<td>12</td>
<td>7</td>
<td>8.4</td>
</tr>
</tbody>
</table>

**Undersea maintenance (where equipment used under salt water or on maintenance barge on salt water) (from 1997 year)**

<table>
<thead>
<tr>
<th>Equipment Type</th>
<th>EUL</th>
<th>DV%</th>
<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
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<tr>
<td>Undersea maintenance equipment (not specified)</td>
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<td>30</td>
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<td>Diesel pump</td>
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<td>40</td>
<td>48</td>
<td>30</td>
<td>36</td>
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<td>Dive compressor</td>
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<td>48</td>
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<tr>
<td>Dive tanks</td>
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<td>20</td>
<td>24</td>
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<td>16.2</td>
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### Industry Categories

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<th>Asset Category</th>
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<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
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<tbody>
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<tr>
<td>Diving helmet</td>
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<td>20</td>
<td>24</td>
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<td>16.2</td>
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<tr>
<td>Drilling rig</td>
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<td>40</td>
<td>48</td>
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<td>36</td>
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<td>100</td>
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<td>48</td>
<td>30</td>
<td>36</td>
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<td>Hammer (pneumatic/hydraulic)</td>
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<td>30</td>
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<td>Jetting pump</td>
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<td>100</td>
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<td>100</td>
<td>100</td>
<td>100</td>
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<tr>
<td>Winches</td>
<td>10</td>
<td>20</td>
<td>24</td>
<td>13.5</td>
<td>16.2</td>
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</tbody>
</table>

### Depreciation rates (assets acquired from 1 April 2005) — asset categories

#### Boilers and heaters (where not industry-specified)

<table>
<thead>
<tr>
<th>Asset Category</th>
<th>EUL</th>
<th>DV%</th>
<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
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<tbody>
<tr>
<td>Boilers and heating plant and equipment (not specified)</td>
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<td>8</td>
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<td>Boilers</td>
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<td>9.6</td>
<td>6</td>
<td>7.2</td>
</tr>
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<td>Boilers (oil)</td>
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<td>9.6</td>
<td>6</td>
<td>7.2</td>
</tr>
<tr>
<td>Boilers (packaged)</td>
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<td>15.6</td>
<td>8.5</td>
<td>10.2</td>
</tr>
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<td>Calorifiers</td>
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<td>9.6</td>
<td>6</td>
<td>7.2</td>
</tr>
<tr>
<td>Chimneys (concrete)</td>
<td>50</td>
<td>4</td>
<td>4.8</td>
<td>3</td>
<td>3.6</td>
</tr>
<tr>
<td>Chimneys (not concrete)</td>
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<td>8</td>
<td>9.6</td>
<td>6</td>
<td>7.2</td>
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<td>Economizers</td>
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<td>9.6</td>
<td>6</td>
<td>7.2</td>
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<td>Flues (concrete)</td>
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<td>3.6</td>
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<td>Flues (not concrete)</td>
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<td>9.6</td>
<td>6</td>
<td>7.2</td>
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<td>Generators (steam)</td>
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<td>13</td>
<td>15.6</td>
<td>8.5</td>
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<td>Handling machines (for coal)</td>
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<td>12</td>
<td>7</td>
<td>8.4</td>
</tr>
<tr>
<td>Heat exchangers (not stainless steel)</td>
<td>20</td>
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<td>12</td>
<td>7</td>
<td>8.4</td>
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</table>
### Depreciation Rates

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<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
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<tbody>
<tr>
<td>Heat exchangers (stainless steel)</td>
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<td>9.6</td>
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<td>Pulverising machines (for coal)</td>
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<td>12.6</td>
</tr>
<tr>
<td>Space heaters (portable)</td>
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<td>48</td>
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<td>Tanks (pressure)</td>
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<td>9.6</td>
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<td>Vessels (pressure)</td>
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<tr>
<td>Water cylinders</td>
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<td>13</td>
<td>15.6</td>
<td>8.5</td>
<td>10.2</td>
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</tbody>
</table>

### Books, music, and manuscripts

Books, editions of which are published annually or more frequently

- Books: 2 100 100 100 100
- Other books: 10 20 24 13.5 16.2
- Manuscripts: 2 100 100 100 100
- Music: 2 100 100 100 100

### Buildings and structures

[Note: The 20 per cent loading does not apply to buildings or to any assets acquired after 20 May 2010.]

- Buildings (default class)(from 2011-12 income year): 50 0 0 0 0
- Structures (default class): 50 4 4.8 3 3.6
- Aprons (airports): 50 4 4.8 3 3.6
- Barns: 20 10 12 7 8.4
- Borewells: 20 10 12 7 8.4
- Bridges (block): 100 2 2.4 1.5 1.8
- Bridges (brick): 100 2 2.4 1.5 1.8
- Bridges (concrete): 100 2 2.4 1.5 1.8
- Bridges (stone): 100 2 2.4 1.5 1.8
- Bridges (other than block, brick, concrete and stone): 50 4 4.8 3 3.6
- Buildings (portable): 12.5 13.5 na 8 na
- Buildings with prefabricated stressed-skin insulation panels: 33.3 4.5 na 3 na
- Buildings with reinforced concrete framing (from 2011-12 income year): 50 0 0 0 0
- Buildings with steel or steel and timber framing (from 2011-12 income year): 50 0 0 0 0
- Buildings with timber framing (from 2011-12 income year): 50 0 0 0 0
- Bunkers (concrete): 20 10 12 7 8.4

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<table>
<thead>
<tr>
<th>Asset Categories</th>
<th>EUL</th>
<th>DV%</th>
<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
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<tr>
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<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>Carparking buildings acquired, or a binding contract entered into for the purchase or construction of the building, on or before 30 July 2009 (from 2011-12 income year)</td>
<td>50</td>
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<td>na</td>
<td>3</td>
<td>na</td>
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<tr>
<td>Carparking pads (from 2011-12 income year)</td>
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<td>4</td>
<td>4.8</td>
<td>3</td>
<td>3.6</td>
</tr>
<tr>
<td>Chemical works</td>
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<td>6</td>
<td>7.2</td>
<td>4</td>
<td>4.8</td>
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<tr>
<td>Dams (earth with rock core)</td>
<td>100</td>
<td>2</td>
<td>2.4</td>
<td>1.5</td>
<td>1.8</td>
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<td>Dams (block)</td>
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<td>2.4</td>
<td>1.5</td>
<td>1.8</td>
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<tr>
<td>Dams (brick)</td>
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<td>2.4</td>
<td>1.5</td>
<td>1.8</td>
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<tr>
<td>Dams (concrete)</td>
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<td>2.4</td>
<td>1.5</td>
<td>1.8</td>
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<tr>
<td>Dams (earth without rock core)</td>
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<td>4.8</td>
<td>3</td>
<td>3.6</td>
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<td>Dams (stone)</td>
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<td>1.8</td>
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<td>Driveways</td>
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<td>Dykes (earth)</td>
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<td>3.6</td>
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<tr>
<td>Equestrian arena, consisting of permanent construction materials (excluding the base course) [provisional rate; applies from the 2010-2011 income year]</td>
<td>12.5</td>
<td>16</td>
<td>19.2</td>
<td>10.5</td>
<td>12.6</td>
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<td>4.8</td>
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<td>Grandstands (from 2011-12 income year)</td>
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<td>0</td>
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<td>3</td>
<td>3.6</td>
</tr>
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<td>Hot houses (of glass or other construction excluding PVC)</td>
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<td>13.5</td>
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<td>8</td>
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<td>Lamp posts (excluding wooden)</td>
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<td>7.2</td>
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<td>Lamp posts (wooden)</td>
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### Depreciation Rates

#### Asset Categories

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<th>SL+20%</th>
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**Building fit-out (when in books separately from building cost)**

| Building fit-out (not specified)                                           | 20  | 10  | 12    | 7   | 8.4    |
| Aerials (for televisions)                                                  | 15.5| 13  | 15.6  | 8.5 | 10.2   |
| Air conditioners (split system)                                            | 10  | 20  | 24    | 13.5| 16.2   |

Staples Tax Guide 2012
### Depreciation Rates

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<thead>
<tr>
<th>Asset Categories</th>
<th>EUL</th>
<th>DV%</th>
<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
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### Depreciation Rates

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<th>SL%</th>
<th>SL+20%</th>
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## Depreciation Rates

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<th>EUL</th>
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<td>13</td>
<td>15.6</td>
<td>8.5</td>
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</table>

### Clothing

- Non-protective clothing (not elsewhere specified) | 3 | 67 | 80.4 | 67 | 80.4 |
- Clothing (for hire) | 3 | 67 | 80.4 | 67 | 80.4 |
- Corporate clothing | 3 | 67 | 80.4 | 67 | 80.4 |
- Costumes (for hire) | 3 | 67 | 80.4 | 67 | 80.4 |
- Uniforms | 3 | 67 | 80.4 | 67 | 80.4 |

### Compressed air plant (where not industry-specified)

- Compressed air plant and equipment (not specified) | 15.5 | 13 | 15.6 | 8.5 | 10.2 |
- Aftercoolers | 12.5 | 16 | 19.2 | 10.5 | 12.6 |
- Air driers | 12.5 | 16 | 19.2 | 10.5 | 12.6 |
- Air receivers (stand alone) | 25 | 8 | 9.6 | 6 | 7.2 |
- Compressors (free-standing) | 15.5 | 13 | 15.6 | 8.5 | 10.2 |
## Depreciation Rates

### Asset Categories

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<tr>
<th>Asset Categories</th>
<th>EUL</th>
<th>DV%</th>
<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
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<td>15.6</td>
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<td>Computer and associated equipment (used for typesetting)</td>
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Staples Tax Guide 2012
### Depreciation Rates

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<th>SL%</th>
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<td>Terminals (without capability of local storage capacity)</td>
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#### Factory and other sundries

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### Depreciation Rates

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<td>13</td>
<td>15.6</td>
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<td>Wheelbarrows</td>
<td>5</td>
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<td>30</td>
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</tr>
<tr>
<td>Wrapper (pallets)</td>
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<td>20</td>
<td>24</td>
<td>13.5</td>
<td>16.2</td>
</tr>
</tbody>
</table>

#### Hire equipment

- Baby gear for hire (excluding child restraints (capsules and car seats)) — from 2007-2008 income year
  - 4 | 50 | 60 | 40 | 48
- Campervans (acquired from the 2010-2011 income year)
  - 8 | 18 | 21.6 | 12.5 | 15
- Motorhomes (acquired from the 2010-2011 income year)
  - 8 | 18 | 21.6 | 12.5 | 15

#### Hire equipment (where on short term hire of one month or less only)

- Agriculture, horticulture and aquaculture machinery for hire with a general DV rate based on a 5-year life
  - 3 | 67 | 80.4 | 67 | 80.4
- Agriculture, horticulture and aquaculture equipment for hire with a general DV rate based on a 15.5-year life
  - 10 | 20 | 24 | 13.5 | 16.2
- Boilers and heaters for hire with a general DV rate based on a 5-year life
  - 3 | 67 | 80.4 | 67 | 80.4
- Cleaning equipment for hire with a general DV rate based on a 3-year life
  - 2 | 100 | 100 | 100 | 100
- Cleaning, refuse and recycling equipment for hire with a general DV rate based on an 8-year life
  - 5 | 40 | 48 | 30 | 36

Staples Tax Guide 2012
<table>
<thead>
<tr>
<th>Asset Categories</th>
<th>EUL</th>
<th>DV%</th>
<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
</tr>
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<tr>
<td>Compact disc players</td>
<td>2</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
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<tr>
<td>Compressed air plant for hire with a general DV rate based on a 10-year life</td>
<td>6.66</td>
<td>30</td>
<td>36</td>
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</tr>
<tr>
<td>Concrete and plaster machinery for hire with a general DV rate based on a 3-year life</td>
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<tr>
<td>Contractors, builders and quarrying plant for hire with a general DV rate based on a 12.5-year life</td>
<td>8</td>
<td>25</td>
<td>30</td>
<td>17.5</td>
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</tr>
<tr>
<td>Contractors, building and quarrying equipment for hire with a general DV rate based on a 15.5-year life</td>
<td>10</td>
<td>20</td>
<td>24</td>
<td>13.5</td>
<td>16.2</td>
</tr>
<tr>
<td>Contractors, building and quarrying equipment for hire with a general DV rate based on an 8-year life</td>
<td>5</td>
<td>40</td>
<td>48</td>
<td>30</td>
<td>36</td>
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<tr>
<td>Contractors, building and quarrying equipment for hire with a general DV rate based on a 5-year life</td>
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<td>100</td>
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<tr>
<td>Contractors, building and quarrying equipment for hire with a general DV rate based on a 3-year life</td>
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<tr>
<td>Digital versatile disc players (DVD players)</td>
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<td>100</td>
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<td>Digital versatile discs (DVD?s)</td>
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<td>Engineering equipment for hire with a general DV rate based on a 5-year life</td>
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<td>67</td>
<td>80.4</td>
<td>67</td>
<td>80.4</td>
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<tr>
<td>Engineering equipment for hire with a general DV rate based on a 12.5-year life</td>
<td>8</td>
<td>25</td>
<td>30</td>
<td>17.5</td>
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<tr>
<td>Fork lift trucks — under 8 tonnes</td>
<td>6.66</td>
<td>30</td>
<td>36</td>
<td>21</td>
<td>25.2</td>
</tr>
<tr>
<td>Fork lift trucks — 8 tonnes and over</td>
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<td>25</td>
<td>30</td>
<td>17.5</td>
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<tr>
<td>Furniture (loose) with a general DV rate of 18% (from the 2006 year)</td>
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<td>50</td>
<td>60</td>
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<td>Lifting equipment for hire with a general DV rate based on a 10-year life</td>
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<td>30</td>
<td>36</td>
<td>21</td>
<td>25.2</td>
</tr>
<tr>
<td>Lifting equipment for hire with a general DV rate based on a 15.5-year life</td>
<td>12.5</td>
<td>16</td>
<td>19.2</td>
<td>10.5</td>
<td>12.6</td>
</tr>
<tr>
<td>Lifting equipment for hire with a general DV rate based on a 12.5-year life</td>
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<td>25</td>
<td>30</td>
<td>17.5</td>
<td>21</td>
</tr>
<tr>
<td>Lifting equipment for hire with a general DV rate based on a 5-year life</td>
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<td>67</td>
<td>80.4</td>
<td>67</td>
<td>80.4</td>
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**Depreciation Rates**

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<tr>
<th>Asset Categories</th>
<th>EUL</th>
<th>DV%</th>
<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
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</thead>
<tbody>
<tr>
<td>Lifting equipment for hire with a general DV rate based on 25-year life</td>
<td>15.5</td>
<td>13</td>
<td>15.6</td>
<td>8.5</td>
<td>10.2</td>
</tr>
<tr>
<td>Marquee accessories (other than poles and frames)</td>
<td>5</td>
<td>40</td>
<td>48</td>
<td>30</td>
<td>36</td>
</tr>
<tr>
<td>Marquee poles (wood)</td>
<td>15.5</td>
<td>13</td>
<td>15.6</td>
<td>8.5</td>
<td>10.2</td>
</tr>
<tr>
<td>Marquee poles and frames (metal)</td>
<td>10</td>
<td>20</td>
<td>24</td>
<td>13.5</td>
<td>16.2</td>
</tr>
<tr>
<td>Marquee poles and frames (metal with integral winching mechanism)</td>
<td>8</td>
<td>25</td>
<td>30</td>
<td>17.5</td>
<td>21</td>
</tr>
<tr>
<td>Marquees (canvas roofs and walls, ropes/tie-downs where permanently attached)</td>
<td>8</td>
<td>25</td>
<td>30</td>
<td>17.5</td>
<td>21</td>
</tr>
<tr>
<td>Marquees (roofs and walls of fabrics other than canvas, ropes/tie-downs where permanently attached)</td>
<td>5</td>
<td>40</td>
<td>48</td>
<td>30</td>
<td>36</td>
</tr>
<tr>
<td>Motor vehicles (for transporting people, up to and including 12 seats)</td>
<td>4</td>
<td>50</td>
<td>60</td>
<td>40</td>
<td>48</td>
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</tbody>
</table>

[Note: the 20 per cent loading does not apply to used imported motorcars.]

<table>
<thead>
<tr>
<th>Asset Categories</th>
<th>EUL</th>
<th>DV%</th>
<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor vehicles, class NA (for transporting light goods that have a gross vehicle mass not exceeding 3.5 tonnes)</td>
<td>6.66</td>
<td>30</td>
<td>36</td>
<td>21</td>
<td>25.2</td>
</tr>
<tr>
<td>Motor vehicles, class NB (for transporting goods that have a gross vehicle mass exceeding 3.5 tonnes but not exceeding 12 tonnes)</td>
<td>8</td>
<td>25</td>
<td>30</td>
<td>17.5</td>
<td>21</td>
</tr>
<tr>
<td>Motor vehicles, class NC (for transporting heavy goods that have a gross vehicle mass exceeding 12 tonnes)</td>
<td>6.66</td>
<td>30</td>
<td>36</td>
<td>21</td>
<td>25.2</td>
</tr>
<tr>
<td>Office equipment and furniture for hire with a general DV rate of based on an 8-year life</td>
<td>5</td>
<td>40</td>
<td>48</td>
<td>30</td>
<td>36</td>
</tr>
<tr>
<td>Party hire equipment</td>
<td>4</td>
<td>50</td>
<td>60</td>
<td>40</td>
<td>48</td>
</tr>
<tr>
<td>Power generation and electrical reticulation systems for hire with a general DV rate based on a 10-year life</td>
<td>8</td>
<td>25</td>
<td>30</td>
<td>17.5</td>
<td>21</td>
</tr>
<tr>
<td>Pumping sets for hire with a general DV rate based on a 12.5-year life</td>
<td>8</td>
<td>25</td>
<td>30</td>
<td>17.5</td>
<td>21</td>
</tr>
<tr>
<td>Pumping sets for hire with a general DV rate based on a 10-year life</td>
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<td>30</td>
<td>36</td>
<td>21</td>
<td>25.2</td>
</tr>
<tr>
<td>Trailers, class TC (for transporting medium goods that have a gross vehicle mass exceeding 3.5 tonnes but not exceeding 10 tonnes)</td>
<td>12.5</td>
<td>16</td>
<td>19.2</td>
<td>10.5</td>
<td>12.6</td>
</tr>
<tr>
<td>Trailers, class TD (for transporting heavy goods that have a gross vehicle mass exceeding 10 tonnes)</td>
<td>10</td>
<td>20</td>
<td>24</td>
<td>13.5</td>
<td>16.2</td>
</tr>
</tbody>
</table>

Staples Tax Guide 2012
## Depreciation Rates

<table>
<thead>
<tr>
<th>Asset Categories</th>
<th>EUL</th>
<th>DV%</th>
<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trailers, classes TA and TB (for transporting very light and light goods that have a gross vehicle mass not exceeding 3.5 tonnes) excluding domestic type trailers</strong></td>
<td>10</td>
<td>20</td>
<td>24</td>
<td>13.5</td>
<td>16.2</td>
</tr>
<tr>
<td><strong>Trailers (domestic type not exceeding one tonne)</strong></td>
<td>6.66</td>
<td>30</td>
<td>36</td>
<td>21</td>
<td>25.2</td>
</tr>
<tr>
<td><strong>Video cassette recorders and/or players (VCR)</strong></td>
<td>2</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
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<tr>
<td><strong>Video game players</strong></td>
<td>1</td>
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<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td><strong>Video game discs</strong></td>
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<td>100</td>
<td>100</td>
<td>100</td>
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<tr>
<td><strong>Lifting</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cranes and other lifting devices (not specified)</td>
<td>25</td>
<td>8</td>
<td>9.6</td>
<td>6</td>
<td>7.2</td>
</tr>
<tr>
<td>Blocks (chain)</td>
<td>10</td>
<td>20</td>
<td>24</td>
<td>13.5</td>
<td>16.2</td>
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<tr>
<td>Blocks (pulley)</td>
<td>10</td>
<td>20</td>
<td>24</td>
<td>13.5</td>
<td>16.2</td>
</tr>
<tr>
<td>Blocks (wire rope)</td>
<td>12.5</td>
<td>16</td>
<td>19.2</td>
<td>10.5</td>
<td>12.6</td>
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<tr>
<td>Boat lift storage system (inflatable) (from 1999-2000 income year)</td>
<td>8</td>
<td>25</td>
<td>30</td>
<td>17.5</td>
<td>21</td>
</tr>
<tr>
<td>Capstans</td>
<td>25</td>
<td>8</td>
<td>9.6</td>
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<td>7.2</td>
</tr>
<tr>
<td>Cranes (derrick)</td>
<td>25</td>
<td>8</td>
<td>9.6</td>
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<td>7.2</td>
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<tr>
<td>Cranes (for containers)</td>
<td>25</td>
<td>8</td>
<td>9.6</td>
<td>6</td>
<td>7.2</td>
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<tr>
<td>Cranes (jib)</td>
<td>25</td>
<td>8</td>
<td>9.6</td>
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<tr>
<td>Cranes (luffing)</td>
<td>25</td>
<td>8</td>
<td>9.6</td>
<td>6</td>
<td>7.2</td>
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<tr>
<td>Cranes (mobile)</td>
<td>15.5</td>
<td>13</td>
<td>15.6</td>
<td>8.5</td>
<td>10.2</td>
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<tr>
<td>Cranes (overhead travelling)</td>
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<td>9.6</td>
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<tr>
<td>Cranes (tower)</td>
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<td>8</td>
<td>9.6</td>
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<td>7.2</td>
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<tr>
<td>Forklift trucks (see Transportation)</td>
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<td>Gantries</td>
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<td>Hoists (skip)</td>
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<td>15.6</td>
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<td>12.6</td>
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<td>Jacks</td>
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<td>Straddle carriers</td>
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<td>Weighers (crane type)</td>
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<td>Winding gear (pit head)</td>
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**Office equipment and furniture**
<table>
<thead>
<tr>
<th>Asset Categories</th>
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<th>DV+20%</th>
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<tr>
<td>Office furniture (not specified)</td>
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<td>Air conditioners (mobile)</td>
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<td>Clock systems (centralised)</td>
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<td>Counters (fitted)</td>
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<td>80.4</td>
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<td>13</td>
<td>15.6</td>
<td>8.5</td>
<td>10.2</td>
</tr>
<tr>
<td>Duplicators (spirit)</td>
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<td>25</td>
<td>30</td>
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<tr>
<td>Duplicators (stencil)</td>
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<td>Facsimile machines</td>
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### Depreciation Rates

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<th>SL%</th>
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**Pumps sets (where not industry-specified)**

| Pumps (not specified)                                 | 10  | 20  | 24     | 13.5| 16.2   |
| Borewell pumps                                        | 10  | 20  | 24     | 13.5| 16.2   |
| Centrifugal pumps                                     | 10  | 20  | 24     | 13.5| 16.2   |
| Dosing pumps                                          | 5   | 40  | 48     | 30  | 36     |
| Drum pumps                                            | 5   | 40  | 48     | 30  | 36     |
| Fire mains pumps                                      | 25  | 8   | 9.6    | 6   | 7.2    |
| Firepumps (portable)                                  | 10  | 20  | 24     | 13.5| 16.2   |
| Geared type pumps                                     | 12.5| 16  | 19.2   | 10.5| 12.6   |
| Hydraulic pumps                                       | 12.5| 16  | 19.2   | 10.5| 12.6   |
| In-line pumps                                         | 10  | 20  | 24     | 13.5| 16.2   |
| Laboratory pumps                                      | 5   | 40  | 48     | 30  | 36     |
### Depreciation Rates

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#### Refrigeration

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Staples Tax Guide 2012
## Depreciation Rates

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### Reticulation systems (excluding electrical, communications, and gas reticulation)

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### Scientific and laboratory equipment (excluding equipment used in medical laboratory)

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<td>Test chambers (acquired in 2010 and later income years; for 2010 and later income years).</td>
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<td>X-ray equipment (except as shown elsewhere)</td>
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Staples Tax Guide 2012
## Depreciation Rates

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<th>SL+20%</th>
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### Software

The copyright in software, the right to use the copyright in software or the right to use software

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### Tanks, vats, and reservoirs (where not industry-specified)

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<td>Reservoirs (other than concrete or lined earth)</td>
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<td><strong>Transportation</strong></td>
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<td>[Note: the 20 per cent loading does not apply to used imported motorcars.]</td>
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<td>Aeroplanes (mechanically propelled, fixed wing, of an unladen weight not exceeding 15,000 kg, other than helicopters) [rate set by legislation from 2005-2006 income year]</td>
<td>15</td>
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<td>Cranes [see Lifting]</td>
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<td>Fire engines</td>
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<td>Fleet tracking unit (provisional asset class, applies from 2011 income year)</td>
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<td>Flight Simulators (FTD and FNPT Certifiable) Aircraft Specific (full-motion) — from 2007-2008 income year</td>
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<td>Freight cars (tramway)</td>
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## Depreciation Rates

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<tr>
<th>Asset Categories</th>
<th>EUL</th>
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<th>DV+20%</th>
<th>SL%</th>
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<td>Minibuses (up to and including 12 seats) [rate set by legislation from 2005-2006 income year]</td>
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<td>Motorhomes (acquired from the 2010-2011 income year)</td>
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<td>Motor vehicles (for transporting people, up to and including 12 seats and used for short-term hire of 1 month or less only)</td>
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<td>50</td>
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## Depreciation Rates

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<tr>
<th>Asset Categories</th>
<th>EUL</th>
<th>DV%</th>
<th>DV+20%</th>
<th>SL%</th>
<th>SL+20%</th>
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<tbody>
<tr>
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<td>Radar navigational traffic control equipment</td>
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<td>Ship loading and unloading equipment (not elsewhere specified)</td>
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<td>12.6</td>
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<td>15.6</td>
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<td>Trailers class TC (for transporting medium goods that have a gross vehicle mass exceeding 3.5 tonnes but not exceeding 10 tonnes)</td>
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<td>12.6</td>
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<tr>
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<td>EUL</td>
<td>DV%</td>
<td>DV+20%</td>
<td>SL%</td>
<td>SL+20%</td>
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<tr>
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<td>--------</td>
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<tr>
<td>exceeding 3.5 tonnes but not exceeding 10 tonnes and used for short-term hire of 1 month or less only</td>
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<td>Trailers class TD (for transporting heavy goods that have a gross vehicle mass exceeding 10 tonnes)</td>
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<td>15.6</td>
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<td>10.2</td>
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<td>Trailers class TD (for transporting heavy goods that have a gross vehicle mass exceeding 10 tonnes and used for short-term hire of 1 month or less only)</td>
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<td>20</td>
<td>24</td>
<td>13.5</td>
<td>16.2</td>
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<tr>
<td>Trailers – domestic. Not exceeding 1 tonne. Used for short-term hire of 1 month or less only.</td>
<td>8</td>
<td>25</td>
<td>30</td>
<td>17.5</td>
<td>21</td>
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<tr>
<td>Trailers (domestic type not exceeding one tonne and used for short term hire)</td>
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<td>36</td>
<td>21</td>
<td>25.2</td>
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<tr>
<td>Tram tracks</td>
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# Depreciation Rates

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## Depreciation Rates

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<th>Asset Categories</th>
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### 5000.40 Amortisation rates for listed horticultural plants

A 20 per cent loading is added to the diminishing value amortisation rate percentage to arrive at the total diminishing value amortisation rate available each income year.

**Note:** A 10 per cent amortisation rate (which does not include the 20 per cent loading), applies to most other horticultural plants that are not listed below.

<table>
<thead>
<tr>
<th>Listed Horticultural Plant</th>
<th>Est useful life (years)</th>
<th>DV Amortisation Rate (%)</th>
<th>With 20% Loading (%)</th>
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<td>Other Rubus</td>
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<td>Lime</td>
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</table>
## Depreciation Rates

### Citrus
- **Mandarin**: 25 years, 6 years, 7.2%
- **Orange**: 25 years, 6 years, 7.2%
- **Tangelo**: 25 years, 6 years, 7.2%

### Grapes
- **Table grapes**: 20 years, 7.5 years, 9%

### Nuts
- **Chestnut**: 20 years, 7.5 years, 9%
- **Hazelnut**: 26 years, 6 years, 7.2%
- **Walnut**: 30 years, 4 years, 4.8%

### Pipfruit
- **Apple**: 15 years, 9.5 years, 11.4%
- **European pear**: 20 years, 7.5 years, 9%
- **Nashi Asian pear**: 15 years, 9.5 years, 11.4%

### Summerfruit
- **Apricot**: 15 years, 9.5 years, 11.4%
- **Cherry**: 20 years, 7.5 years, 9%
- **Plum**: 15 years, 9.5 years, 11.4%
- **Nectarine**: 12 years, 9.5 years, 14.4%
- **Peach**: 12 years, 12 years, 14.4%

### Vegetables
- **Asparagus**: 6 years, 22 years, 26.4%

### Others
- **Avocado**: 20 years, 7.5 years, 9%
- **Feijoa**: 18 years, 7.5 years, 9%
- **Hop**: 10 years, 15 years, 18%
- **Kiwifruit**: 20 years, 7.5 years, 9%
- **Olives**: 500 trees per hectare, 20 years, 7.5 years, 9%
- **500 trees per hectare (typically hedges)**: 15 years, 9.5 years, 11.4%
- **Passionfruit**: 4 years, 33 years, 39.6%
- **Persimmon**: 25 years, 6 years, 7.2%
- **Tamarillo**: 4 years, 33 years, 39.6%
INDEXES
**Case Table**

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<th>Description</th>
<th>Abbreviation</th>
<th>Description</th>
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**Subpart BB**

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| EZ 3 | EZ 4 |
| EZ 5 | EZ 6 |
| EZ 7 | EZ 8 |
| EZ 9 | EZ 10 |
| EZ 11 | EZ 12 |
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| FA 3 | FC 3 |
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| FA 5 | FC 5 |
| FA 6 | FC 8A(1), FC 8F, FC 8G |
| FA 7 | FC 8A(2), (3), OB 1 |

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  - IG 2(2)(e), (4)(c), (d), (5)(b), (e)
- **IP 2**
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- **IP 3**
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- **IP 4**
  - IG 2(4)
- **IP 5**
  - IG 2(2)(b)-(f), (5)
- **IP 6**
  - IF 1(2), (3), IG 2(4)(c), (d), (5)(c), (d), (10)
- **IP 7**
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- **IQ 1**
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- **IQ 2**
  - IE 2(2), (3), (5)
- **IQ 3**
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- **IQ 4**
  - IG 5
- **IQ 5**
  - IG 7(2)
- **IQ 6**
  - IG 7(4)
- **IQ 7**
  - IG 7(5)
- **IQ 8**
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**Subpart IS**

- **IS 1**
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- **IS 2**
  - IH 1(1), IH 5
- **IS 3**
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  - IH 4(3) proviso
- **IS 5**
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- **IS 6**
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**Subpart IT**

- **IT 1**
  - II 1(3), (4), II 3

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- **IV 1**
  - IF 7
- **IV 2**
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- **LW 1**
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- **LW 2**
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- **LW 3**
  - LC 1(1)(d)
- **LW 4**
  - LC 1(1)(e)
- **LW 5**
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- **LW 6**
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- **LW 7**
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- **LW 8**
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- **LW 9**
  - LB 1(1)(j)
- **LW 10**
  - LB 1(1)(k), LB 2(3), (4)
- **LW 11**
  - LB 1(1)(l), LB 2(4)

**Subpart LF**

- **LF 1**
  - LB 1(1)(i), LB 2(1), (2), (3), (4)
- **LF 2**
  - LB 1(1)(j), LB 2(4)
- **LF 3**
  - LB 1(1)(k), LB 2(5), (6)
- **LF 4**
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**Subpart LC**

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- **LC 7**
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- **LD 2**
  - LC 5(1)
- **LD 3**
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**Subpart LE**

- **LE 1**
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- **LE 4**
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- **LE 5**
  - LB 1(1)(a), (2), (3), (3A)
- **LE 6**
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  - LB 2(1C)
- **LE 8**
  - LB 1(1)(c)
- **LE 9**
  - LB 1(1)(e), (5)
- **LE 10**
  - LB 1(1)(f), LB 2(5), (6)
- **LE 11**
  - LB 1(1)(g), LB 2(4)

**Subpart LF**

- **LF 1**
  - LB 1(1)(i), LB 2(1), (1B), (1C)
- **LF 2**
  - LB 1(1)(ab), LB 1A
- **LF 3**
  - LB 1(1)(a), (2), (3), (3A)
- **LF 4**
  - LB 1(1)(b), (4), (4A), (4B)
- **LF 5**
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- **LF 6**
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- **LF 7**
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**Note:** The table above represents a summary of section numbers and amounts from the Tax Administration Act 1994. Each section number is linked to its respective amount. The table is designed to provide a clear and concise overview of the tax administration-related amounts and sections.
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### Layby Sales

- **Definition**: Layby sales are a type of sale where the customer pays a deposit on an item and then makes periodic payments until the item is delivered. The sale is considered complete only when the final payment is made.

- **Impact of GST Rate Change**: When the GST rate changes, the tax liability on layby sales is recalculated based on the new rate. This is done by applying the new rate to the total amount of the layby agreement to date, and the adjusted amount is then passed through to the customer.

### Lease Inducement Payments

- **Definition**: Lease inducement payments are provided to tenants as incentives to enter into a lease agreement. These payments can be in the form of cash, rent-free periods, or other services.

- **Impact of GST Rate Change**: Lease inducement payments are deductible to the recipient of the payment. If the rate of GST changes, the net amount of the deductible is adjusted to reflect the new rate, which affects the amount of tax that can be deducted by the recipient.

### Legal Expenses

- **Definition**: Legal expenses refer to the costs incurred in the course of legal services. This includes fees paid to lawyers, accountants, and other legal professionals.

- **Impact of GST Rate Change**: Legal expenses are generally treated as ordinary and necessary expenses. If the rate of GST changes, the deduction for legal expenses is adjusted to reflect the new GST rate, impacting the net amount of deductible expenses.

### Local Authority Rates

- **Definition**: Local authority rates are fees imposed by local governments for services such as garbage collection, water, and sewage.

- **Impact of GST Rate Change**: Local authority rates are not subject to GST. However, if local authorities provide goods and services that are subject to GST, the rate of GST may change, affecting the total amount charged by the local authority.

### Loyalty Programme Transactions

- **Definition**: Loyalty programmes are schemes where customers earn points or rewards for their purchases. These programmes often involve periodic payments or payments based on the customer's spending.

- **Impact of GST Rate Change**: Loyalty programme transactions are generally exempt from GST. If the rate of GST changes, the exempt status of these transactions remains, but the tax liability on other transactions may be recalculated.

### Mixed Use of Goods and Services

- **Definition**: Mixed use of goods and services refers to the use of the same goods and services in both taxable and non-taxable activities.

- **Impact of GST Rate Change**: When the GST rate changes, the taxable and non-taxable portions of mixed use goods and services are recalculated to reflect the new rate. This may affect the overall tax liability.

### New Start Grant, Relief Provision

- **Definition**: New start grants provide financial assistance to newly established businesses. Relief provisions may be available to help businesses during start-up or expansion periods.

- **Impact of GST Rate Change**: New start grants and relief provisions may be affected by changes in the GST rate. This can impact the amount of tax-free relief granted to businesses.

### Place of Supply

- **Definition**: The place of supply is the location where the supply of goods or services occurs. This affects the jurisdiction in which GST is payable.

- **Impact of GST Rate Change**: Changes in the GST rate can affect the place of supply. For example, if the rate changes, the tax implications may shift from one jurisdiction to another, depending on the location of the supply.

### Postal Delivery

- **Definition**: Postal delivery refers to the shipment of goods or services by mail. This is a common method of delivery for businesses and consumers.

- **Impact of GST Rate Change**: Changes in the GST rate can affect the tax implications of postal delivery. This can impact the calculation of GST on deliveries and the amount of refund or tax payable.

### Priority of Amount Owing on Bankruptcy, Liquidation, Receivership, or Mortgagee Sale

- **Definition**: Priority of amount owing refers to the order in which creditors are paid in the event of a business failure. This is determined by relevant laws and regulations.

- **Impact of GST Rate Change**: Changes in the GST rate can affect the priority of amount owing. This can impact the tax liabilities and obligations of creditors during a bankruptcy, liquidation, receivership, or mortgagee sale.

### Private Training Establishments

- **Definition**: Private training establishments are businesses that provide training services to individuals. These establishments may be subject to GST.

- **Impact of GST Rate Change**: Private training establishments are generally subject to GST. If the rate changes, the tax liability for these establishments may be recalculated to reflect the new rate.
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**Penalties**

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**Penalties**

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